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RECENT DECISIONS

CONSTITUTIONAL LAW—THE WITNESS PROTECTION PROGRAM: INVESTIGATING THE RIGHT TO COMPANIONSHIP, DUE PROCESS, AND PREEMPTION

[Those people] moving in down the street are probably exactly what they seem to be—just folks setting up housekeeping in a strange town. But these days they could also be people with freshly minted identities: Government-aided fugitives attempting to shed the past and escape someone's vengeance after a lifetime of violence and criminality.¹

A unique and problematic family situation develops when a divorced parent becomes a government witness or becomes involved with a person who testifies against members of organized crime. In exchange for the witness' testimony, the government offers protection against threats of retaliation. Under the federal Witness Protection Program² (WPP), the United States Marshals Service relocates the

¹ TIME, Sept. 12, 1972 at 41, col. 3.

² Congress established the Witness Protection Program (WPP) under Title V of the Organized Crime Control Act of 1970. 18 U.S.C. *prec.* § 3481 (1976). It provides:

Sec. 501. The Attorney General of the United States is authorized to provide for the security of Government witnesses, potential Government witnesses, and the families of Government witnesses and potential witnesses in legal proceedings against any person alleged to have participated in an organized criminal activity.

Sec. 502. The Attorney General of the United States is authorized to rent, purchase, modify, or remodel protected housing facilities and to otherwise offer to provide for the health, safety, and welfare of witnesses and persons intended to be called as Government witnesses, and the families of witnesses and persons intended to be called as Government witnesses in legal proceedings instituted against any person alleged to have participated in an organized criminal activity whenever, in his judgment, testimony from, or willingness to testify by, such a witness would place his life or person, or the life or person of a member of his family or household, in jeopardy. Any person availing himself of an offer by the Attorney General to use such facilities may continue to use such facilities for as long as the Attorney General determines the jeopardy to his life or person continues.

Sec. 503. As used in this title, "Government" means the United States, any State, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, any political subdivision, or any department, agency, or instrumentality thereof. The offer of facilities to witnesses may be conditioned by the Attorney General upon reimbursement in whole or in part to the United States by any State or any political subdivision, or any department, agency, or instrumentality thereof of the cost of maintaining and protecting such witnesses.

Sec. 504. There is hereby authorized to be appropriated from time to time such funds as are necessary to carry out the provisions of this title.

witness and his family and provides them with new identities and supporting documentation.³

When a WPP participant brings along a child from a previous marriage,⁴ all ties with the nonparticipating parent have been severed. The nonparticipating parent, unable to maintain a continuing relationship with his natural child, has turned to the federal courts for relief.⁵

In *Leonhard v. Mitchell*,⁶ an early case decided prior to the enactment of the WPP, the United States Court of Appeals for the Second Circuit affirmed dismissal of a father's action seeking to disclose the location and identity of his children.⁷ But in two recent cases, federal courts of appeals have recognized that a parent not participating in the WPP retains some parental rights. In *Ruffalo v. Civiletti*,⁸ the Eighth Circuit recognized that the parent-child relationship was a constitutionally protected liberty interest. In affirming a denial of partial summary judgment, the *Ruffalo* court refused to compel the child's return to the nonparticipating parent.⁹ In a similar case, *Franz*

3 The United States Marshals Service administers the WPP. 28 C.F.R. § 0.111(c) (1982).

4 Generally, the parent has a custody decree from a state divorce proceeding. See notes 7, 9, and 11 *infra*.

5 See notes 6-13 *infra* and accompanying text.

6 473 F.2d 709 (2d Cir.), *cert. denied*, 412 U.S. 949 (1973).

7 In *Leonhard*, a divorced father sought a writ of mandamus to compel Justice Department officials to reveal the location of his three children. Custody of the children had been awarded to their mother who later remarried an underworld crime figure, Pascal Calabrese. Calabrese possessed information valuable to the government's prosecution of the local mob, but a murder contract had been put on Calabrese's family. Calabrese conditioned his testimony on the government's promise to provide protection to himself and his family. Under government direction, the entire family received new identities and two relocations. Subsequently, Leonhard tried unsuccessfully to contact his children but the only government official with the information refused to divulge it. The Court of Appeals for the Second Circuit rejected Leonhard's due process claims, finding no express constitutional right to custody or visitation. Since the Justice Department official had not abused his discretion, mandamus was inappropriate. *Id.* at 713-14.

8 539 F. Supp. 949 (W.D. Mo. 1982), *aff'd*, 702 F.2d 710 (8th Cir. 1983).

9 Donna Ruffalo sought the return of her child who had been included with his father in the WPP. Although Donna purported to have "custody" of the child, her ex-husband maintained "possession" and support of the child pursuant to an agreement. *Id.* at 712. Donna Ruffalo based her claims on the due process clause of the fifth amendment, alleging violation of a liberty interest without the constitutional prerequisite of a hearing. Recognizing that the constitutional rights involved were not absolute, the Eighth Circuit remanded for a hearing to determine Donna's motivation and if necessary, an equitable decree which would minimize the danger to her son and former husband. On remand, the district court denied the full injunctive relief sought on an "unclean hands" basis. 565 F. Supp. 34 (W.D. Mo. 1983). Donna's ties with organized crime made the litigation a "vehicle of intended homicide." *Id.* at 36. The court, however, granted Donna's claim to visitation and communication on the stipulation that the defendants comply with "appropriate security arrangements." *Id.* at 37.

v. United States,¹⁰ the District of Columbia Circuit held that a father had stated a claim against WPP administrators for violation of his and his children's rights to companionship.¹¹ The court remanded the case to determine the merits and appropriate relief. In a separate statement to *Franz*,¹² Judge Bork argued that the threshold issue in this situation should have been whether the federal interest in the WPP preempted traditional state regulation of family matters.¹³

Leonhard, *Ruffalo*, and *Franz* present issues that transcend their unique factual settings. Part I of this comment analyzes the right of companionship, what the contours of that right are, and who possesses it. Assuming such a right is cognizable, Part II focuses on how it must be protected against governmental intrusion and asks what process is due an individual whose right to companionship is infringed. Part III examines whether Congress intended the WPP to preempt the state domain of family law, particularly where the right to companionship is involved. Finally, Part IV suggests further procedural protections necessary to ensure minimal governmental intrusion into the parent-child relationship.

For further discussions of *Leonhard* and *Ruffalo*, see *Hearings Before the Permanent Subcomm. on Investigations of the Comm. on Government Affairs*, 96th Cong., 2d Sess. 31-39 (1980) [hereinafter cited as *1980 Hearings*].

10 707 F.2d 582 (D.C. Cir. 1983).

11 William Franz and his wife Catherine had three children before their separation and divorce. William had exercised his visitation rights until Catherine and the children entered the WPP. *Id.* at 589. Thereafter, William was unable to locate the children or establish contact with them. William claimed that by completely severing the relationship between a non-custodial parent and his children without their participation or consent, the government officials violated the father's and children's constitutionally protected rights of companionship. Although the District of Columbia Circuit did not reach the merits, it set forth four requirements before a parent-child relationship can be severed:

(a) the asserted governmental interest must be compelling; (b) there must be a particularized showing that the state interest in question would be promoted by terminating the relationship; (c) it must be impossible to achieve the goal in question through any means less restrictive of the rights of parent and child; and (d) the affected parties must be accorded the procedural protections mandated by the Due Process Clauses.

707 F.2d at 602. See also *Salmeron v. United States*, No. 83-1596 (9th Cir. Dec. 28, 1983), where the court held that the government could not avoid potential liability by denying responsibility for relocating children in violation of a custody decree. The father brought suit after his children and ex-wife enrolled in the WPP. The Ninth Circuit reversed a summary judgment against the father because of material issues of fact concerning the validity of the father's release of his civil rights claims. The court did not rule on whether the father stated a valid claim in tort or a violation of his constitutional rights.

12 *Franz v. United States*, 712 F.2d 1428, 1434 (D.C. Cir. 1983) (addendum opinion) (Bork, J., concurring in part, dissenting in part).

13 See notes 96-100 *infra* and accompanying text.

I. Right of Companionship

A. *Parent's Perspective*

1. Origin of the Right

To determine the origin of previously undefined or ill-defined liberty interests, the Supreme Court of the United States has suggested the following approach:

[T]he full scope of the liberty guaranteed by the Due Process Clause cannot be found in or limited by the precise terms of the specific guarantees elsewhere provided in the Constitution. . . . [This type of liberty] is a rational continuum which, broadly speaking, includes a freedom from all substantial arbitrary impositions and purposeless restraints, . . . and which also recognizes . . . that certain interests require particularly careful scrutiny of the state needs asserted to justify their abridgement.¹⁴

The constitutional right of companionship issues from this due process guarantee of liberty.¹⁵ The right of companionship is one of those liberties which, although not specifically mentioned anywhere in the Constitution, has attained sufficient societal status to "require particularly careful scrutiny" before it is terminated.¹⁶

Apart from the question of its textual origin, though, the right to companionship originated in *Stanley v. Illinois*¹⁷ where the Supreme Court concluded that "it is plain that the interest of a parent in the *companionship*, care, custody, and management of his or her child 'comes to this Court with a momentum for respect' "¹⁸ which is not present when reviewing purely economic interests. This position of respect for parent-child relationships, in fact, follows consistently the

14 *Moore v. City of East Cleveland*, 431 U.S. 494, 502 (1977) (plurality opinion) (quoting *Poe v. Ullman*, 367 U.S. 497, 542-43 (1961)) (Harlan, J., dissenting). In *Moore*, an East Cleveland ordinance allowed only one family to live in a house. Mrs. Moore lived in her home with her son and two grandchildren. However, the grandchildren were first cousins. The statute defined "family" in such a way that the relatives living in Mrs. Moore's house did not qualify as one family. She was convicted of violating the ordinance. The Supreme Court reversed the conviction and struck down the ordinance, holding that Mrs. Moore's extended family constituted a protected unit.

15 Although the quoted passage refers to due process as reflected in the fourteenth amendment, the analysis applies equally to the due process restraints in the fifth amendment.

16 For other examples of such rights, see *Shapiro v. Thompson*, 394 U.S. 618 (1969) (right to travel); *Griswold v. Connecticut*, 381 U.S. 479 (1965) (privacy).

17 405 U.S. 645 (1972). In *Stanley*, the plaintiff was an unwed father. His children were placed in guardianship upon their mother's death. Stanley contended that absent a hearing to prove neglect on his part or parental unfitness, the state could not remove his children from him. The Court agreed with Stanley and found the Illinois procedure to be unconstitutional.

18 *Id.* at 651 (quoting *Kovacs v. Cooper*, 336 U.S. 77, 95 (1949)) (emphasis added).

Court's historical approach to family interests. In *Santosky v. Kramer*,¹⁹ the majority reiterated that "freedom of personal choice in matters of family life is a fundamental liberty interest protected by the Fourteenth Amendment."²⁰ From the Court's perspective, these fundamental family interests, although permitted but not created by the Constitution, have their actual source in "intrinsic human rights"²¹ as well as in the history and tradition of our country.²²

Upon similar bases of intrinsic rights and history, the parent-child relationship has been accorded fundamental liberty status. In *Lassiter v. Department of Social Services*,²³ when fundamental family interests were translated into the context of a child custody action, the Supreme Court determined that "a parent's desire for and right to 'the companionship, care, custody, and management of his or her children' is an important interest that, . . . absent a powerful countervailing interest, [requires] protection."²⁴ One year later, in *Santosky*, the Supreme Court clearly and specifically stated that such a parent-child relationship constituted the core of a "fundamental liberty interest."²⁵

2. Factors Triggering the Right to Companionship

Courts have progressively defined what factors will be used to determine whether a protected parent-child relationship exists. Therefore, successful construction of a general approach to the prob-

19 455 U.S. 745 (1982). John and Annie Santosky were the parents of Tina, John III, and Jed. After incidents of parental neglect, the Department of Social Services initiated a neglect proceeding against Mr. and Mrs. Santosky. The three children were subsequently removed. The New York procedure requires that the court find permanent neglect before the parent-child relationship is terminated. While this continues to be the case, the Court held that the private interest involved was so strong that the courts must make their determinations by clear and convincing evidence, not simply by a preponderance. *Id.* at 769.

20 *Id.* at 753.

21 *Smith v. Organization of Foster Families For Equality and Reform*, 431 U.S. 816, 845 (1977) [hereinafter cited as *OFFER*]. In *OFFER*, foster parents sought declaratory and injunctive relief against New York State, alleging that its foster child removal procedure violated the due process clause. The foster parents argued that after one year, the psychological and emotional ties between the foster parents and children became so great that the foster home became the child's family. The Court held that even if the foster home situation created a liberty interest in the foster parents, the New York procedure, providing for notice, hearing, appeal, and judicial review, was sufficient. *Id.* at 856.

22 *Id.* at 845.

23 452 U.S. 18 (1981). In *Lassiter*, the infant son of a North Carolina woman was removed from the mother after a finding of parental neglect. The state petitioned to terminate her parental rights. On writ of certiorari, the Supreme Court determined that assistance of counsel is not constitutionally mandated in every parental rights termination proceeding.

24 *Id.* at 27.

25 *Santosky*, 455 U.S. at 754 n.7, 759.

lem is possible after examining some of the factual points upon which previous cases have turned.

An initial inquiry necessarily concerns the ties between parent and child. However, there is disagreement whether biological ties, alone, will trigger a fundamental liberty interest.²⁶ Clearly, parents have an "essential" right to conceive children.²⁷ However, the majority position suggests that the mere existence of that biological relationship will not exclusively determine a protected family interest.²⁸ In essence, the concept of family includes more than the simple fact that a child has been born.²⁹ In explaining this position, the Supreme Court mentioned that "a deeply loving and interdependent relationship between an adult and a child in his or her care may exist even in the absence of blood relationship."³⁰ In so stating, the Justices suggest that the existence of love and interdependence may be sufficient to create a protected family. Although these terms, especially "love," are not easily defined, they are useful in understanding one facet of the Court's approach. Seemingly, in cases which show a potential family right interest, the Court will be willing to consider human emotional characteristics in addition to objective biological or economic factors.

A second level of inquiry deals with more objective criteria. The Supreme Court has enunciated several factors it considers necessary to establish the type of parent-child relationship which will trigger protection. Probably the most tenuous of these factors focuses on a parent's expectation regarding the degree of lasting interest in the relationship. In *Smith v. Organization of Foster Families for Equality and Reform*,³¹ the Court dealt with a foster family that felt it had not received appropriate due process before the state removed one of the foster children from its care.³² While deciding that the foster family was accorded sufficient due process in the removal action, Justice Brennan highlighted the fact that the foster family was created by a contractual agreement with the state. Therefore, the existence of a

26 See notes 28-29 *infra*.

27 *Stanley v. Illinois*, 405 U.S. 645, 651 (1972).

28 *OFFER*, 431 U.S. at 843.

29 Strongly opposed to this view, Justice White, dissenting in *Lehr v. Robertson*, 103 S. Ct. 2985, 2999 (1983), contended that "the biological connection is itself a relationship that creates a protected interest."

30 *OFFER*, 431 U.S. at 844.

31 431 U.S. 816 (1977).

32 Although the case is important in that the Supreme Court came very close to finding that the emotional and psychological ties of a foster family were akin to those of a natural family, the issue is collateral to this discussion.

contractual expectation that the foster children were only placed in the home on a temporary basis argued "against any but the most limited constitutional 'liberty' in the foster family."³³ The Court's holding suggests that if a parent expects or should expect that the relationship with the child cannot reach its full potential, that expectation will operate to decrease the degree of protection afforded the parent-child relationship.

Other related factors arose in *Quilloin v. Walcott*,³⁴ a case in which an unwed natural father alleged due process violations in the adoption process. In holding that the unwed father's parental relationship could be accorded markedly less protection than that of married or divorced fathers, the Supreme Court found it highly relevant that he "never shouldered any significant responsibility with respect to the daily supervision, education, protection, or care of the child."³⁵ Similarly, the Court in *Lehr v. Robertson*³⁶ was faced with a putative father who claimed a due process violation in his not being given notice of his daughter's adoption proceeding. Among the many factors which prompted the Court to find against the father, Justice Stevens noted that the father "never established any custodial, personal, or financial relationship" with his daughter.³⁷ Therefore in these two cases, the Supreme Court has emphasized that the following factors are informative in determining whether a protected parent-child relationship exists: 1) protection and care for the child; 2) custody for the child; 3) responsibility for the child's education; 4) financial support for the child; and 5) supervision of the child's daily activities.

Significantly, *Quilloin* also raised an interesting point regarding the relative degree of protection afforded to relationships. In stating that an unwed father's rights can justifiably be less than those of a divorced father, Justice Marshall, speaking for the Court, noted that "even a father whose marriage has broken apart will have borne *full*

33 431 U.S. at 846. The statute creating the limited contractual expectation reads:

The custody of a child placed out or boarded out and not legally adopted or for whom legal guardianship has not been granted shall be vested during his minority, or until discharged by such authorized agency from its care and supervision, in the authorized agency placing out or boarding out such child and any such authorized agency may in its discretion remove such child from the home where placed or boarded.

N.Y. SOC. SERV. LAW § 383(2) (McKinney 1976).

34 434 U.S. 246 (1978).

35 *Id.* at 256.

36 103 S. Ct. 2985 (1983).

37 *Id.* at 2996.

responsibility for the rearing of his children during the period of the marriage.”³⁸ If Justice Marshall is correct in his opinion, all cases adjudicating the custody rights of divorced parents will put in issue a fundamental liberty interest.

3. Applications of a Right to Companionship

A few Supreme Court decisions as well as some lower federal court opinions add some substance to the words “companionship, care, custody, and management.” *Stanley v. Illinois* established the idea that a parent’s companionship interest in his or her child could be accorded constitutional protection.³⁹ In *Stanley*, although not expressly stated, the Court found a liberty interest similar to that found in *Santosky*.⁴⁰ In so doing, the Court determined that an unwed father could not be deprived of his children upon the death of their mother without some degree of due process protection.⁴¹ So, even though Stanley and the then deceased mother were not married at the time the children were born and Stanley never legitimated the children, the state would necessarily have to conduct a hearing to determine Stanley’s unfitness as a parent before the children could become wards of the state. “The private interest here, that of a man in the children he has sired and raised, undeniably warrants deference and, absent a powerful countervailing interest, protection.”⁴²

In *Santosky*, the Court struggled with the parents’ interest in their children in an attempt to determine the proper standard of proof required to terminate those rights. The Santoskys were married; however, the Department of Social Services removed three of their children because they found the children were neglected.⁴³ In deciding that a higher standard of proof would be necessary to terminate the parental rights (clear and convincing evidence rather than simply a preponderance), the Court extended this fundamental interest of companionship to cover natural parents who have been accused of neglect. Speaking for the Court, Justice Blackmun said:

38 *Quilloin*, 434 U.S. at 256 (emphasis added).

39 See note 17 *supra* and accompanying text.

40 In *Stanley*, the Court determined that the unwed father could not be denied a hearing as to his fitness as a parent. Although the case was decided on equal protection grounds, the Court’s implicit first step was to find that the father’s relationship was sufficient to overcome the presumption of his unfitness and to put him on an equal standing with other parents.

41 *Stanley*, 405 U.S. at 658.

42 *Id.* at 651.

43 The New York procedure allowed termination of parental rights upon a showing of permanent neglect. *Santosky*, 455 U.S. at 747.

The fundamental liberty interest of natural parents in the care, custody, and management of their child does not evaporate simply because they have not been model parents or have lost temporary custody of their child to the State. Even when blood relationships are strained, parents retain a vital interest in preventing the irretrievable destruction of their family life.⁴⁴

Although this language refers to natural parents who may be neglectful, a court could apply the same analysis to the "strained" blood relationships after a divorce.

Thus, the Supreme Court decisions indicate that at least two types of parents have a fundamental liberty interest in their relationship with their child: (1) an unwed natural father claiming rights to his children after their mother's death, and (2) married natural parents who have been accused of neglect. These parents are afforded the due process protections of the fifth and fourteenth amendments.

Lower federal courts have found that other parents have a liberty interest in their relationship with their children. In *Siereveld v. Conn.*,⁴⁵ the District Court for the Eastern District of Kentucky relied on *Santosky*, among other cases, to stand for the premise that "the right of a person to raise his or her own family is an interest of profound and fundamental importance."⁴⁶ Thus, the court required a hearing to afford due process protection either before or soon after Kentucky's Cabinet for Human Resources removed a child from the care of her natural mother.⁴⁷

Another example of this approach is *Rivera v. Marcus*,⁴⁸ where the Court of Appeals for the Second Circuit found a liberty interest worthy of due process protection in a foster family relationship where the children's older half-sister also served as their foster parent. Significantly, the court noted, with criticism, that the focus of the courts has principally been on only "the biological relationship between the parties when extending due process protection to persons not specifically fitting the parent-child mold."⁴⁹

The federal courts, then, have found a liberty interest in the par-

44 *Id.* at 753.

45 557 F. Supp. 1178 (E.D. Ky. 1983).

46 *Id.* at 1182.

47 *Id.* at 1183.

48 696 F.2d 1016 (2d Cir. 1982). In *Rivera*, the Second Circuit came very close to finding a protected interest in a standard foster family (where there are no biological ties between the foster parents and children). Pointing out that it did not decide the issue, the court said "[we] leave for another day the question of the constitutionality of the . . . procedures applied to foster parents as such." *Id.* at 1029.

49 *Id.* at 1022.

ent-child relationship worthy of due process protection where the parent asserting the liberty interest is: (1) an unwed natural father, (2) natural parents accused of neglect, (3) a custodial natural mother, or (4) a foster mother who is also a blood relation. The narrowed approach of these actual applications adequately supports protected fundamental liberty interests between children and their natural parents who happen to be separated by divorce.⁵⁰ The divorced parents in *Leonhard*, *Ruffalo*, or *Franz* would qualify as blood relatives who have not been determined neglectful or unfit, thus deserving of due process protection.

4. Unresolved Questions

The Supreme Court has not yet determined what rights, if any, a natural parent not participating in the WPP has in maintaining a continuing relationship with a child who is in the program. Simply stated, the question is whether a state court custody order, which had already limited or defined parental rights, would have any effect upon the existence of a fundamental liberty interest. In *Ruffalo*, the two parents (Donna and Michael) divorced in 1972. At that time, Donna received custody of their son, Mike. Later, Donna and Michael modified the decree and Michael received an ill-defined right to "possession" of the child while Donna retained a de facto right to visitation. The question is whether this procedure, or some other state court determination as a result of a divorce proceeding, affects an otherwise existing fundamental liberty interest in the "companionship, care, custody, and management" of one's children.⁵¹

Whether a state court order granting modified parental rights (like visitation) would affect the liberty interest of a parent in his children is unclear, but the more reasoned answer seems to be that it

50 Notably, the factors set out in Section 2 of this comment would permit a more expansive application, ostensibly finding protected interests between parties who do not have blood ties.

51 A number of cases have attempted to avoid the problem of coming to court with only a right of visitation by having the non-custodial parent petition the court for a revised custody order. In such a revised order, custody is normally granted to the previously non-custodial parent after a showing that the WPP participant (the custodial parent) violated the original custody agreement by hiding the children. As expected, the U.S. Marshals (who administer the WPP) have rarely enforced such revised orders, refusing to return the children. Presumably, the Marshal does not comply since it could threaten the security of a program participant. The Marshals essentially engage in selective enforcement. At first, by virtue of the custodial authority granted in the original state order, the WPP removes the children on the consent of the custodial parent. However the WPP administrators then ignore the revised custody order.

would not. None of the previously mentioned cases directly deals with the issue. Nonetheless, their approach would seem to indicate that a fundamental liberty interest survives a divorce. As mentioned, a blood relationship, although not determinative, is a significant factor when a court assesses whether or not a protected parental interest exists.⁵² And, even if the blood relationship is strained, *Santosky* suggests that a vital interest still exists.⁵³

Furthermore, couples institute divorce actions not because of the children but because they can no longer live as a couple. Children by necessity either become wards of the state or stay with one of the two parents. The court is left to decide with which parent the child will stay. In its determination, the court affirmatively chooses whichever situation is in the best interest of the child.⁵⁴ The considerations are pragmatic. The "best interest" may be accomplished by one parent contributing custodial care while the other parent—quite possibly the higher wage earner—contributes financial support and is allowed visitation. The approach is not necessarily a negative one, since the court does not declare the non-custodial parent to be unfit, less loving, or less emotionally attached to the child. The bifurcation in the proceeding (divorce arising because of the differences between the parents; custody focusing on the best interest of the child) creates no necessary inference that one parent is unfit. As such, the custody/non-custody distinction does nothing to diminish the fundamental liberty interest of a parent in the "companionship, care, custody, and management" of his children.⁵⁵

52 See notes 28 and 29 *supra* and accompanying text.

53 *Santosky v. Kramer*, 455 U.S. 745, 753 (1982).

54 *OFFER*, 431 U.S. at 852; *Quilloin*, 434 U.S. at 254.

55 *Lassiter*, 452 U.S. at 38-42. The words of Justice Blackmun capture the significance of the parental interest:

Although the Constitution is verbally silent on the specific subject of families, freedom of personal choice in matters of family life long has been viewed as a fundamental liberty interest worthy of protection under the Fourteenth Amendment. . . . The Court has accorded a high degree of constitutional respect to a natural parent's interest both in controlling the details of the child's upbringing, and in retaining the custody and companionship of the child. . . . A termination of parental rights is both total and irrevocable. Unlike other custody proceedings, it leaves the parent with no right to visit or communicate with the child, to participate in, or even know about, any important decision affecting the child's religious, educational, emotional, or physical development. . . . The fundamental significance of the liberty interests at stake in a parental termination proceeding is undeniable, . . . [and weighs] heavily in favor of refined procedural protections.

B. *Child's Perspective*

The problems in the WPP cases raise parent-child issues; as such, it is necessary to give some consideration to the child's rights. As the relationship between parent and child is constitutionally protected⁵⁶ a focus on the parental side looks at only half of the issue.⁵⁷

The present assumptions about children's rights demand immediate clarification. In some cases, the child's rights are considered only in the sense that the court believes them to be subsumed into parental interest;⁵⁸ in other cases, the child's interests are substantially ignored.⁵⁹ This approach is grounded in a belief that the child is too young or immature to affirmatively and rationally state his interests.⁶⁰ But, recognizing a child's immaturity would seem to demand greater child representation. If the child cannot speak for himself, then the court should appoint someone who can properly represent the child's interest. Curiously, the Supreme Court has not dealt extensively with children's rights. In discussing the preponderance standard in *Santosky*, the Court said that the lower courts erred in the assumption that termination of the natural parents' rights in a neglect case would invariably benefit the child.⁶¹ The Court noted that without more information about the situation, permanent removal from the home will not necessarily improve the child's welfare even when the natural home is imperfect.⁶² This same invalid assumption underlies the WPP cases. In a WPP situation, a non-custodial parent still has some rights in his relationship with the child (either statutory or constitutional). But, the Marshals Service simply assumes that the children will be better off if they relocate with the custodial parent, permanently severing all contacts with the non-custodial parent. Like the lower court in *Santosky*, the Marshals Service has no basis in fact for that assumption. A reasoned approach suggests that this assumption is also invalid.⁶³

The state's role in parent-child relationships also needs clarification.

56 *Quilloin v. Walcott*, 434 U.S. 246, 255 (1978).

57 *See In re Gault*, 387 U.S. 1, 13 (1967). "Whatever may be their precise impact, neither the Fourteenth Amendment nor the Bill of Rights is for adults alone." *Id.*

58 *OFFER*, 431 U.S. at 841 n.44. *See also*, *Parham v. J.R.*, 442 U.S. 584, 601-04 (1979). Absent a showing of abuse or neglect, parents retain a substantial, if not dominant, role in deciding whether to voluntarily commit a child for treatment. *Id.*

59 *Santosky*, 455 U.S. at 758-61.

60 *OFFER*, 431 U.S. at 841 n.44.

61 *Santosky*, 455 U.S. at 765 n.15.

62 *Id.*

63 The assumption is invalid because, though it may be true in some cases, assuming it is true in all cases ignores the reality of particular family situations.

tion. The state has a "*parens patriae* interest in preserving and promoting the welfare of the child."⁶⁴ The "*parens patriae* interest favors preservation, not severance, of the natural familial bonds" as long as the parent-child relationship has a chance of being positive and nurturing.⁶⁵ Both the child and the child's parents "share a vital interest in preventing erroneous termination of their natural relationship," absent a state showing of parental unfitness.⁶⁶ The state has a duty to provide for the best interest of the child,⁶⁷ and if at all possible, the state's primary focus should be on preserving the existing natural familial bonds.⁶⁸

In addition to the state's *parens patriae* interest, a child has specific needs which should be considered. Child development textbooks detail the needs of children, their dependency on adults, and the harmful effects of incomplete or irregular adult relationships.⁶⁹ In addition to these clinically stated needs, the Christian Children's Fund has outlined other needs in "Rights of Children."⁷⁰ Included

64 *Santosky*, 455 U.S. at 766.

65 *Id.* at 766-67.

66 *Id.* at 760.

67 *OFFER*, 431 U.S. at 852; *Quilloin*, 434 U.S. at 254.

68 A series of cases dealing with child adoption record disclosure presents an informative approach to the area of child's rights. *See Alma Society v. Mellon*, 601 F.2d 1225 (2d Cir. 1979); *Dixon v. Department of Pub. Health*, 116 Mich. App. 763, 323 N.W.2d 549 (1982); *Bradey v. Children's Bureau*, 275 S.C. 622, 274 S.E.2d 418 (1981); *Linda F.M. v. Department of Health*, 52 N.Y.2d 236, 418 N.E.2d 1302 (1981); *In re Roger B.*, 84 Ill. 2d 323, 418 N.E.2d 751 (1981). The parties petition as adults; however, the incidents of asserting a child-type right still remain. In the majority of these cases, the children petition to open the adoption records in order to discover the identity of their parents or to seek aid in the treatment of a physical or mental disorder. *Alma Society*, 601 F.2d at 1233. A compelling need of the child is a prerequisite to opening the adoption records. However, other interests, besides the child's, are addressed. The court looks to the nature of all the relationships and to the fact that choices have been made by those other than the adopted child. *Id.* Thus, in the adoption cases, the child's compelling interest must compete with the privacy interest of the natural parents as well as the interests of the adoptive parents. And, on the whole, when the rights of both the natural and adoptive parents are weighed, the courts have chosen to withhold any material which may identify the natural parents. *Linda F.M.*, 52 N.Y.2d at 239, 418 N.E.2d at 1304.

This line of adoption cases readily translates, at least in part, into the context of the WPP cases. In the adoption cases, the only reason why the courts withhold identifying material from the children is to protect the privacy of the natural parents and to avoid destroying the family which the adoptive parents have tried to create. If it were not for these countervailing interests, presumably the child would be allowed to know his parents' identities. No such countervailing rights exist in the WPP cases. In fact, the opposite is true. In the WPP cases, the non-custodial parents actually want to see their children; as such no competing right should interfere with the relationship between the non-custodial parent and the child, without some form of hearing to determine the rights of the parties.

69 *See, e.g.*, H. BERNARD, *HUMAN DEVELOPMENT IN WESTERN CULTURE* (5th ed. 1978).

70 *Id.* at 277.

among the many stated rights are: a name, nationality, affection, love, understanding, nutrition, and education.⁷¹ Every child is not going to receive a full share of all these requirements. And, psychologists recognize that of those rights which are being met, the rights need not necessarily be fulfilled by a child's natural parents. However, where the state has granted custody and visitation privileges involving both parents, a child would seem to have a vested interest that both his natural mother and natural father be given a chance to fulfill those needs before anyone else. On this point, the Supreme Court has said "it is cardinal with us that the custody, care and nurture of the child reside first in the parents, whose primary function and freedom include preparation for obligations the state can neither supply nor hinder."⁷² Thus, at best, the child has a right to receive his care from a natural parent. And in this respect, taking the children into the WPP does not violate this right since the child remains with the custodial parent. However, if the state court has determined that the child can receive his care from both custody and visitation rights (two sources) the problem arises when the WPP administrators decide that there need be only one source—that of the WPP administrators' own choosing.

The parents and children, then, have related but distinct rights. A parent has a protected fundamental liberty interest in the "companionship, care, custody and management" of his or her child. In addition, the state is charged with the duty to help the child along by providing for the child's best interest should some difficulty arise in the family situation.

The child has a fundamental right to companionship distinct from that of his parents. This interest is the reciprocal component of the parent's interest and is triggered by a child's right to have his physical and emotional needs served by at least one natural parent. However, where the state courts have created custody and visitation rights in which both parents participate, the U.S. Marshals Service should not arbitrarily deprive the child of the nonparticipating parent's contribution.

II. Determining What Process is Due

Having recognized a parent's fundamental liberty interest in the care and custody of his child and the child's reciprocal interest in receiving care from the parent, the government must provide due

⁷¹ *Id.*

⁷² *Stanley v. Illinois*, 405 U.S. 645, 651 (1972).

process before it terminates the relationship.⁷³ The government can not make the decision to admit or retain a witness and his family in the WPP if that decision would terminate a parent-child relationship without affording certain procedural protections. The notion of fairness inherent in the due process clause requires an opportunity to be heard "at a meaningful time and in a meaningful manner."⁷⁴

Determining what process is due requires a balancing of the three factors set out in *Mathews v. Eldridge*.⁷⁵ (a) the private interest at stake, (b) the government's interest in support of its program, and (c) the risk that established procedures will lead to erroneous decisions.⁷⁶

A. *Private Interests*

The individual liberty interest of a parent in the care and custody of his child is a fundamental right deserving of substantial protection under the fifth amendment.⁷⁷ The potential injury to a nonparticipating parent whose child has been placed in the WPP is termination of a meaningful family relationship. The seriousness and finality of the government intrusion commands a higher level of procedural protection than where the government temporarily infringes upon the liberty interest. Where the government acts to permanently and totally sever the parent-child relationship, a "commanding" interest must be recognized.⁷⁸ The right to the care and custody of one's child is an interest "far more precious . . . than property rights."⁷⁹

Furthermore, the administrators of the WPP have refused to

73 The Supreme Court has noted: "[S]tate intervention to terminate the relationship between [a parent] and [the] child must be accomplished by procedures meeting the requisites of the Due Process Clause." *Santosky v. Kramer*, 455 U.S. 745, 753 (1982) (quoting *Lassiter v. Department of Social Services*, 452 U.S. 18, 37 (1981) (Blackmun, J., dissenting)).

74 *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965). In *Armstrong*, the Supreme Court held that failure to give a divorced father notice of pending adoption proceedings deprived him of due process of law. *Id.* at 550.

75 424 U.S. 319 (1976). The question presented in *Mathews* was whether a disabled worker had a constitutional right to a full evidentiary hearing prior to termination of his disability benefits. After analyzing the governmental and private interests at stake, the Supreme Court determined that a pretermination hearing was not required where administrative procedures provided adequate due process. *Id.* at 349.

76 *Id.* at 335.

77 *Stanley v. Illinois*, 405 U.S. 645, 651-52 (1972).

78 *Lassiter v. Department of Social Services*, 452 U.S. 18, 27 (1981).

79 *May v. Anderson*, 345 U.S. 528, 533 (1953). See also *Stanley*, 405 U.S. at 651.

accommodate the needs of the nonparticipating parent.⁸⁰ A frustrated parent, having obtained a state custody order, will be unable to enforce it unless the United States Marshals facilitate compliance or reveal the location and identity of the program participants, neither of which seems likely in the present program.

B. *Government Interests*

The competing governmental interests center around the goals of the WPP: the suppression of organized crime and the protection of the witness and his family.⁸¹ A successful program must ensure the safety of the witnesses both in fact and in appearance, to encourage potential witnesses to come forward without fear of retribution.

The government must of necessity act quickly and secretly once the decision has been made to accept a witness. Subsequent measures may be required to retain the witness in the program and unless the participants completely sever old contacts, their lives may be endangered.

The governmental interests, however, must be compelling before the natural bond between parent and child can be broken. Only when it would be impossible to achieve the goals of the WPP by less restrictive means must the familial right of companionship yield to the public interest.⁸² The Court of Appeals for the District of Columbia Circuit has suggested that the burden shifts to the government to make a "particularized showing of advantage" when its actions will deprive an individual of a fundamental right.⁸³ In addition, proof must be made by "clear and convincing evidence."⁸⁴

Whether a hearing would impose significant administrative and fiscal burdens must be considered in light of the important liberty interests at stake. An evidentiary hearing to comply with due process will increase operational expense, but as Justice Brennan recognized, "[a]dministrative fairness usually does."⁸⁵

C. *Inherent Risk in Existing Procedures*

Finally, the reliability and fairness of existing procedures, must be evaluated. The structure of the WPP requires the Assistant Attor-

80 See, e.g., *Franz v. United States*, 707 F.2d 582, 590 (D.C. Cir. 1983); *Ruffalo v. Civiletti*, 702 F.2d 710, 713 (8th Cir. 1983).

81 See note 2 *supra*.

82 *Franz v. United States*, 707 F.2d 582, 602 (D.C. Cir. 1983). See note 11 *supra*.

83 *Id.*

84 *Santosky v. Kramer*, 455 U.S. 745, 769 (1982).

85 *Richardson v. Wright*, 405 U.S. 208, 227 (1972) (Brennan, J., dissenting).

ney General to make an ex parte decision whether a person qualifies as a witness.⁸⁶ A qualifying witness is one whose testimony will advance the federal interest and whose life is in present danger.⁸⁷ At no time in the witness admission proceeding do federal officials inquire into or try to accommodate the rights of nonparticipating family members.⁸⁸ No notice or opportunity to be heard was given prior to or immediately following the government's decision to accept a witness and his or her family in the program in either *Franz* or *Ruffalo*.⁸⁹ Yet the government interest might only be "marginally advanced" and the parent's deprivation might be permanent, irreversible, and incapable of judicial review.⁹⁰

Furthermore, the nature of the inquiry poses inherent risks. When dealing with family questions, evidence will be at best uncertain. Psychological and sociological factors, as well as individual character and motivation, will play prominent roles. The nature of the relevant information will not be found in unbiased reports or expert testimony. Oral evidentiary hearings thus become a necessary procedural safeguard before the government can intrude into the family domain.⁹¹

Having established that a hearing is a constitutional prerequisite to government action that terminates a parent-child relationship for the sake of the WPP, the courts disagree over when the hearing should be held,⁹² and which branch of the federal government bears responsibility for promulgating its standards.⁹³

III. The Preemption Question

Leonhard v. Mitchell, *Ruffalo v. Civiletti*, and *Franz v. United States* exhibit the clash between state court custody or visitation decrees,

86 See note 2 *supra*.

87 Justice Dep't Order O.B.D., 2110.2, Jan. 10, 1975, reprinted in *Hearings Before the Subcomm. on Administrative Practice and Procedure of the Committee on the Judiciary*, 95th Cong., 2d Sess. 135 (1978)[hereinafter cited as *1978 Hearings*].

88 *Franz v. United States*, 707 F.2d at 588.

89 See *id.* at 608; *Ruffalo v. Civiletti*, 702 F.2d at 713.

90 *Franz*, 707 F.2d at 607-08.

91 Cf. *Santosky v. Kramer*, 455 U.S. at 769 (1982).

92 In *Ruffalo*, the Eighth Circuit called for a post-deprivation hearing, recognizing that advance notice would undermine the secrecy of the WPP. 702 F.2d at 715. The District of Columbia Circuit in *Franz*, while agreeing that a post-deprivation hearing might be necessary in extreme circumstances, recommended that the government conduct the hearing prior to its decision to admit a program participant. 707 F.2d at 608-09.

93 Despite the guidelines set forth, the court in *Franz* properly called on Congress or the WPP officials for more definitive direction in protecting and accommodating the rights of the parties affected by the WPP. 707 F.2d at 610.

the individual right of companionship, and federal legislation designed to combat organized crime.⁹⁴ The conflict presents significant federalism concerns under the preemption doctrine, where federal legislation conflicts with the states' police power.⁹⁵ Courts must determine whether to follow state or federal law.

Of the cases involving the rights of a parent whose ex-spouse has enrolled in the WPP, only the *Franz* court specifically addressed the preemption issue and the role of federal courts in handling domestic relations law.⁹⁶ Judge Bork filed a separate opinion in *Franz* in which he examined whether Congress intended that the WPP operations should preempt state law where the two conflict.⁹⁷ His conclusions differ from the majority opinion in *Franz*. Judge Bork argued that there was insufficient evidence to determine whether Congress intended to preempt matters of family law,⁹⁸ an area almost exclusively handled in state courts.⁹⁹ He also noted that in assessing whether federal legislation is to preempt state law, a higher level of scrutiny should be employed where matters of family law are involved.¹⁰⁰

94 See notes 7-11 *supra* and accompanying text.

95 The supremacy clause provides that federal legislation preempts state law in the event of a conflict:

This Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under Authority of the United States, shall be The Supreme Law of the Land; and The Judges in every state shall be bound Thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. CONST. art. VI, § 2.

96 In *Ruffalo*, the Eighth Circuit did discuss the conflict between the state courts' province and the goals of the WPP. The court, however, did not address the intent of Congress in establishing the WPP in light of the preemption doctrine. The court noted:

The rights of parents, to be sure, are not absolute. Compelling public necessity can justify their termination if proper procedures are followed. We recognize that the Witness Protection Program had been authorized by Congress and is an important part of the war against organized crime. But there is no evidence that Congress intended a separation of parent and child in a situation like that present here.

702 F.2d at 715 (8th Cir. 1983).

97 *Franz v. United States*, 712 F.2d 1428, 1434 (D.C. Cir. 1983) (addendum opinion) (Bork, J., concurring in part, dissenting in part).

98 *Id.* at 1435. "Congress, in creating the Witness Protection Program, apparently did not consider whether the federal interest in combatting organized crime required it to displace the interests of the states in regulating family relations." See also *id.* at 1437.

99 *Id.* at 1435 (citing *Sosna v. Iowa*, 419 U.S. 393, 404 (1975)). The *Ruffalo* court also recognized that handling family law issues is traditionally the province of state courts. See *Ruffalo*, 702 F.2d at 717.

100 *Franz*, 712 F.2d at 1435-36 (addendum opinion) (Bork, J. concurring in part, dissenting in part) (citing *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 581 (1979), wherein the Supreme Court referred to several cases indicating that a higher level of scrutiny was necessary for determining whether Congress intended to preempt state law in the area of domestic relations.) See *United States v. Yazell*, 32 U.S. 341, 352 (1966) ("State family and family-prop-

The *Franz* majority, however, pointed to the broad discretion delegated to the Attorney General¹⁰¹ in administering the WPP as the source of congressional intent to preempt.¹⁰² Judge Edwards noted that under the Organized Crime Control Act, Congress intended "the Attorney General to act, on occasion, in a manner that might be at odds with visitation rights. . . . It is inconceivable that Congress did not anticipate that implementation of the Witness Protection Program might adversely affect the rights of third parties (such as creditors and non-custodial parents)."¹⁰³ Similarly, other federal courts have pointed to the broad discretion of the Attorney General in denying claims against the government where a WPP participant has injured a third party.¹⁰⁴ Is this broad delegation of authority, however, an appropriate measure for determining whether Congress intended to preempt state law, particularly where family law issues and the individual right to companionship are involved?

The federal government has an obvious interest in combatting crime. Although the WPP has been under attack,¹⁰⁵ the program has been effective in inducing persons to supply valuable information in cases against members of organized crime.¹⁰⁶ The states have a legitimate interest in the realm of family law. Where both the federal and state governments exercise legitimate power, the focus shifts to the intent of Congress in assessing whether, under the supremacy

erty law must do 'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will demand that state law be overridden."); *Ohio ex rel Popvici v. Agler*, 280 U.S. 379 (1930); *Westmore v. Markoe*, 196 U.S. 68 (1904).

101 The Attorney General's powers are outlined under Title V of the Organized Crime Control Act of 1970. See note 2 *supra*.

102 *Franz v. United States*, 712 F.2d 1428 (D.C. Cir. 1983) (addendum opinion) (Edwards, J.).

103 *Id.* at 1429. For a discussion involving the conflict between a creditor seeking a judgment against a WPP participant whose location the government will not divulge, see *Melo-Tone Vending, Inc. v. United States*, 666 F.2d 687 (1st Cir. 1981), where the court, in affirming the dismissal of the creditor's complaint, held that placing a debtor in the WPP did not constitute a "taking" under the Fifth Amendment.

104 In *Bergmann v. United States*, 689 F.2d 789 (8th Cir. 1982), the court held that selection of a WPP participant who murdered a police officer came under the discretionary function exception of the Federal Torts Claim Act. In *Garcia v. United States*, 666 F.2d 960 (5th Cir. 1982), the court affirmed the dismissal of a WPP participant's *Bivens* action against the government. The court held that plaintiff's constitutional rights were not violated when the government dismissed the drug informer from the WPP after he gave newspaper interviews. The court pointed to the broad discretion delegated to the Attorney General in selecting and dismissing WPP participants. *Id.* at 963. See also *Melo-Tone*, 666 F.2d 687 (1st Cir. 1981).

105 The problems facing the WPP include: recidivism among participants, failure to secure credit, ineffective and delayed documentation, poor training of the U.S. Marshals, and the difficulty for participants to find employment. See 1980 Hearings, *supra* note 9, at 7.

106 1980 Hearings, *supra* note 9, at 2 (Opening Statement of Senator Nunn).

clause, federal law is to preempt the state law.¹⁰⁷ Because the Organized Crime Control Act does not expressly reserve power to the states nor does the Act expressly state that Congress, recognizing a potential conflict, intends that the Act preempt matters of family law and individual rights, the inquiry focuses on the implied intent of Congress.¹⁰⁸ The judiciary must then examine the thrust and legislative history of the federal act.¹⁰⁹

*Rice v. Sante Fe Elevator Corp.*¹¹⁰ enunciated the criteria for determining federal preemption where Congress legislated in an area tra-

107 See *Rice v. Sante Fe Elevator Corp.*, 331 U.S. 218, 229-31 (1947).

108 *Id.*

109 The tests for determining preemption have varied in the past five decades and are somewhat dependent on subject matter. See Note, *The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court*, 75 COL. L. REV. 623 (1975). The following cases exhibit the Supreme Court's changing attitude toward preemption—attitudes which result in changes in the allocation of power between the federal and state governments.

In *Hines v. Davidowitz*, 312 U.S. 52 (1941), the Supreme Court struck down the Pennsylvania Alien Registration Act of 1939, pointing out that existing federal law ought not to be complemented or restricted by state laws. The Court, focusing upon the supremacy of federal law in the field of foreign affairs, outlined the considerations for determining preemption, absent express intent: the object sought to be obtained, the nature of the power exerted by Congress, and the character of the obligations imposed by law. *Id.* at 70.

Applying the most relevant of the above criteria, "the object sought to be obtained," Congress has a strong interest in battling organized crime and the WPP is an effective weapon in the arsenal, yet the termination of familial bonds is only a peripheral unintended result of the legislation, a result which limits the individual right to companionship.

In *Hines*, Justice Black remarked that the legislation which imposed greater obligations on aliens than United States citizens differs from the more typical cases under the regulatory scheme of the commerce clause. The legislation "deals with the rights, liberties and personal freedoms of human beings and is in an entirely different category from state tax statutes or food laws regulating the labels on cans." *Id.* at 68. The Court, however, did not outline the nature of judicial inquiry required where preemption involves individual rights. Judge Bork, in *Franz*, also suggested that a higher level of scrutiny should be required where federal law preempts matters of family law. 712 F.2d at 1435 (addendum opinion) (Bork, J., concurring in part, dissenting in part); see note 100 *supra* and accompanying text. State law protection of individual rights may require a similarly high level of examination.

In *Pennsylvania v. Nelson*, 350 U.S. 497 (1956), the Supreme Court reformulated the standard from "inconsistency" with the federal statute to a situation where enforcement of a state act presents a "serious danger of conflict with the administration of the federal program." *Id.* at 505. In assessing the preemption issue the Court also pointed to two other established factors, the pervasiveness of the federal regulation which implies that Congress left no room for supplementation by states, *id.* at 502, and the dominance of federal interest such that the federal system must be assumed to preclude enforcement of state law on the same subject, *id.* at 504.

110 331 U.S. 218 (1947). Customers of warehousemen alleged that the elevator company violated provisions of the Illinois Public Utilities Act and Illinois Grain Warehouse Act. The Court, in examining each violation separately, found that the United States Warehouse Act superseded state regulation except where the federal law failed to cover a field or where the legislation expressly provided that the states maintained a power to regulate.

ditionally occupied by the states.¹¹¹ The Court noted that the necessarily "clear and manifest" intent of Congress may be evidenced "where the state policy may produce a result inconsistent with the objective of the federal statute."¹¹²

In *Ruffalo*, *Franz*, and *Leonhard* the state laws presenting conflicts with the Organized Crime Control Act were neither an attempt to supplement federal law nor law on the same subject.¹¹³ The federal law presented obstacles to enforcement of the state court visitation or custody decrees.¹¹⁴ The courts, however, did not investigate whether the state laws present a "serious danger of conflict with the administration of the program."¹¹⁵

Judge Bork's separate statement in *Franz* echoes a recent Supreme Court preemption decision. In *New York Department of Social Services v. Dublino*,¹¹⁶ the Court, relying on a 1952 case,¹¹⁷ reiterated the need to look closely at the intent of Congress. The Court stated:

If Congress is authorized to act in a field, it should manifest its intention clearly. It will not be presumed that a federal statute was intended to supersede the exercise of the power of the state unless there is a clear manifestation of intention to do so. The exercise of federal supremacy is not lightly to be presumed.¹¹⁸

As the Court noted in *Hisquierdo v. Hisquierdo*,¹¹⁹ in determining preemption, the state family law must do "major damage" to "clear and substantial" federal interests before, under the supremacy clause, federal law will rule. The majority in *Franz* did not apply this test.

111 The Court established the test where,

[w]e start with the assumption that the historic police powers of the states were not to be superseded by the Federal Act unless that was the clear and manifest intent of Congress. . . . Such a purpose may be evidenced in several ways. The scheme of federal regulation may be so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it. . . . Or the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject. . . . Likewise, the object sought to be obtained by the federal law and character of obligations imposed by it may reveal the same purpose. . . . Or the state policy may produce a result inconsistent with the objective of the federal statute.

Id. at 230.

112 *Id.*

113 Unlike *Rice*, where both the state and federal laws centered on regulating warehouse operations, *see* note 109 *supra*, these cases involve state family law and federal crime control.

114 *See, e.g., Franz v. United States*, 707 F.2d 582, 585 (D.C. Cir. 1983).

115 *See Pennsylvania v. Hines*, 350 U.S. 497, 505 (1956) and note 109 *supra*.

116 413 U.S. 405 (1973).

117 *Schwartz v. Texas*, 344 U.S. 199 (1952).

118 413 U.S. at 413 (1973).

119 439 U.S. 572, 581 (1979). *See* note 100 *supra*.

Judge Edwards stated that Congress, in granting broad authority to the Attorney General in administering the WPP, must have considered the program's effect on non-custodial parents.¹²⁰ The history of the WPP, however, exhibits Congress' failure to address the issue—providing little basis for determining federal preemption. The original program, implemented under the Organized Crime Control Act, included purchasing and maintaining "safe houses" for witnesses during pending litigation and while in danger.¹²¹ The original program administrators contemplated providing protection to 25 to 50 people who would be kept in safe houses during their testimony and would then return to normal life.¹²² Considering this small scale inception of the WPP,¹²³ Congress did not likely anticipate conflicts arising between state domestic relations law and the WPP. The temporary participation would not result in termination of companionship rights. Courts should consider that Congress delegated this "broad discretion" to the Attorney General at this embryonic stage of the program, discretion which the *Franz* majority now interprets as authority to usurp state power.¹²⁴

Not only did Congress leave a vacuum of information for determining the preemption issue but the legislature, cognizant of problems arising between non-custodial parents and the burgeoning¹²⁵ WPP operations, has provided little guidance for the courts. In 1978, Congress was informed that the new policy of the Marshals Service included providing a parent, whose child has been relocated under the WPP, access to the child "if the circumstances are proper," but not necessarily revealing the child's location.¹²⁶ But the Marshals Service did not think the situation was a problem at the time.¹²⁷ The limited statutory authority and the regulations governing the WPP operations fail to address the issue.

120 *Franz v. United States*, 712 F.2d at 1429 (addendum opinion) (Edwards, J.).

121 *1978 Hearings*, *supra* note 87, at 37-39 & Appendix at 274.

122 *1980 Hearings*, *supra* note 9, at 242. (Statement of Mr. Howard Safir, Assistant Director for Operations, U.S. Marshals Service.)

123 *See, e.g.*, H.R. REP. NO. 91-1549, 91st Cong., 2d Sess. 2 reprinted in 1970 U.S. CODE CONG. & AD. NEWS, 4008, 4024-26.

124 707 F.2d at 586-88. Although the Memorandum of Understanding between the participant and the government purports to prevent violation of state court custody decrees, recent cases exhibit that the Marshals Service has acted in opposition to those orders. *See 1978 Hearings*, *supra* note 87, at Appendix 2, and *Salmeron*, *supra* note 11, at 6101.

125 During the first ten years of the WPP, the government has protected and relocated over 12,000 individuals, providing far more sophisticated protection than the original "safe houses." *1980 Hearings*, *supra* note 9, at 242.

126 *1978 Hearings*, *supra* note 87, at 123.

127 *Id.*

If courts do not require Congress to "manifest an express intent" to preempt state law as *Dublino*¹²⁸ and Judge Bork suggest,¹²⁹ the legislature will continue to authorize broad discretion in the executive branch, authority which may not be examined, as in the WPP, for several years after implementation of law. This broad delegation of authority carries greater significance where the statutory implementation invades an area of law traditionally handled in state courts and where individual rights are involved. In such situations, not only must Congress address the preemption issue, but as the *Dublino* Court states, "federal supremacy is not lightly to be presumed."¹³⁰

Courts should be wary of finding congressional intent to preempt, particularly where intent is based on a broad delegation of power to the executive branch. Courts' acceptance of this implied preemption provides Congress no incentive to consider the consequences of executive department operations, which left unchecked, can result in usurping the power of state courts. Where constitutionally protected liberty interests exist and where state courts have traditionally and exclusively resolved disputes, federal courts should not tolerate a less than clear manifestation to preempt.¹³¹

IV. Conclusion

Congress not only frustrated the federal courts' determination of the preemption issue, but Congress also left the courts ill-equipped to determine the appropriate balance between WPP operations and the individual right of companionship. The parents and children, in cases such as *Leonhard*, *Ruffalo*, and *Franz* possess a fundamental liberty interest in the constitutionally protected right of companionship. If federal law does not preempt, the outstanding state custody decree remains in force.

If Congress manifests a clear intent to preempt, or if federal courts presume preemption, the fundamental nature of the right of companionship requires procedural due process protection before it can be infringed upon. Fundamental fairness necessitates a hearing prior to the decision to admit a witness and his family in the WPP,

128 See note 116 *supra* and accompanying text.

129 *Franz v. United States*, 712 F.2d at 1436 (addendum opinion) (Bork, J., concurring in part; dissenting in part.)

130 See notes 116-118 *supra* and accompanying text.

131 See also *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 581 (1978). See also Parental Kidnapping Prevention Act of 1980, 18 U.S.C.A. § 1073 (West. Supp. 1982), where Congress exhibited the capability to clearly manifest an attempt to preempt state family law.

absent extreme danger. At this hearing, the court should apply a "clear and convincing" standard to the following:

- a) the government's plan to accommodate the companionship rights of both the participating and nonparticipating parents as well as that of the child;
- b) the plan which most effectively ensures the safety of the parties;
- c) a determination of whether the child's best interest will be served by inclusion in the WPP; and
- d) the nonparticipating parent's motivation in asserting his rights (whether or not the nonparticipating parent has ties to organized crime).

Applying these factors will protect the right of companionship from intrusive government action.

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INTERNATIONAL LAW—ACT OF STATE DOCTRINE: AN EMERGING CORRUPTION EXCEPTION IN ANTITRUST CASES?

The act of state doctrine precludes American courts, both federal and state, from inquiring into the validity of the public acts which a recognized foreign sovereign power commits within its own territory.¹ Courts justify applying the doctrine on two bases, international comity² and separation of powers.³

Although important policy concerns underlie the act of state doctrine,⁴ application of the doctrine sometimes leads to unjust results between litigants in a particular action. Such injustice occurs particularly in international antitrust actions involving corruption of foreign officials.⁵ For example, in an antitrust case, the plaintiff may allege that the defendant bribed a foreign sovereign into granting it an oil concession, thus damaging the plaintiff, a competitor also seeking the concession.⁶ However, the plaintiff's otherwise legitimate an-

1 See *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 401 (1964); *Underhill v. Hernandez*, 168 U.S. 250, 252 (1897). The question is not one of jurisdiction. Application of the act of state doctrine in a particular case does not deprive the court of jurisdiction to hear the case; rather, it narrows the issues of the case by refusing to inquire into and accepting as valid the action of a foreign government. See, e.g., *D'Angelo v. Petroleas Mexicanos*, 331 A.2d 388 (Del. 1974).

2 The American courts have justified application of the doctrine based on international comity considerations since the Supreme Court first enunciated the doctrine in *Underhill v. Hernandez*, 168 U.S. at 252. See, e.g., *Oetjen v. Central Leather Co.*, 246 U.S. 297 (1918); *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1909). In *Underhill*, the Court stated that the act of state doctrine recognizes the respect one sovereign state owes to the independence of another. 168 U.S. at 252. Thus, *Underhill* is often quoted as the classic statement of the comity rationale underlying the act of state doctrine.

3 In a more recent enunciation of the doctrine, *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. at 423, the Supreme Court relied on separation of powers as the basis for applying the act of state doctrine. The Supreme Court held that the principle of separation of powers provided a constitutional basis for the doctrine: "The act of state doctrine . . . arises out of the basic relationships between branches of government in a system of separation of powers." *Id.* See also *International Ass'n of Machinists v. OPEC*, 649 F.2d 1354, 1359 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982).

4 See notes 14-24 *infra* and accompanying text.

5 See, e.g., *Clayco Petroleum Corp. v. Occidental Petroleum Corp.*, 712 F.2d 404 (9th Cir. 1983) *petition for cert. filed*, 52 U.S.L.W. 3463 (U.S. Sept. 30, 1983) (No. 83-546); *Hunt v. Mobil Oil Corp.*, 550 F.2d 68 (2d Cir. 1977), *cert. denied*, 434 U.S. 984 (1978).

6 Such a suit would involve not only questions regarding the application of the act of state doctrine but also questions regarding the extraterritorial reach of the United States antitrust laws. American antitrust laws undoubtedly extend to some conduct in other nations. See *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597, 608 (9th Cir. 1976). The Sherman Act, 15 U.S.C. §§ 1, 2 (1976), and with it other antitrust laws, has been applied to extraterritorial conduct. See, e.g., *Continental Ore Co. v. Union Carbide & Carbon Corp.*,

titrust suit may fail simply because the defendant involved a foreign sovereign in its scheme, and the act of state doctrine prohibits a court from inquiring into either the validity of the foreign sovereign's act or the motivation behind that act.⁷ Thus, the defendant has effectively used the act of state doctrine to shield its illegal anticompetitive activity from review by American courts.

Two recent decisions, *Clayco Petroleum Corp. v. Occidental Petroleum*

370 U.S. 690 (1962); *United States v. Sisal Sales Corp.*, 274 U.S. 268 (1927); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945) (the "Alcoa" case). For an extended discussion of this evolution, see 1 W. FUGATE, FOREIGN COMMERCE AND THE ANTITRUST LAWS §§ 2.10-2.29 (3d ed. 1982).

American antitrust laws, however, do not embrace all conduct beyond United States borders. Extraterritorial application involves other countries and at some point the interests of the United States are too weak and the foreign harmony incentive too strong to justify an extraterritorial assertion of jurisdiction. What that point is or how it is determined is not defined by international law. See Miller, *Extraterritorial Effects of Trade Regulation*, 111 U. PA. L. REV. 1092, 1094 (1963). Nor does the Sherman Act limit itself. In *Timberlane*, 549 F.2d at 609 n.14, for example, the court stated that the tendency seems to be for federal regulatory statutes to contain sweeping jurisdictional language. The Sherman Act reaches "every contract . . . in restraint of trade" and "[e]very person who shall monopolize, or attempt to monopolize . . . any part of . . . the trade or commerce among the several States, or with foreign nations." 15 U.S.C. §§ 1, 2 (1976).

Courts usually assume extraterritorial jurisdiction based on an activity's effect on American foreign commerce. Nevertheless, neither American courts nor commentators agree on how much of an effect is required. Some courts have held that a "direct and substantial effect" on United States foreign commerce is required. See, e.g., *United States v. R. P. Oldham Co.*, 152 F. Supp. 818, 822 (N.D. Cal. 1957); *United States v. General Elec. Co.*, 82 F. Supp. 753, 891 (D. N.J. 1949), *judgment implementing decree*, 115 F. Supp. 835 (D. N.J. 1953). Several commentators have also endorsed a "direct and substantial effect" requirement. See, e.g., W. FUGATE, *supra*, § 2.12; J. VAN CISE, UNDERSTANDING THE ANTITRUST LAWS 204 (1973); RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 18 (1965).

Other courts have used different expressions to describe conduct which would support an exercise of extraterritorial jurisdiction. See, e.g., *Thomsen v. Cayser*, 243 U.S. 66, 88 (1917) ("the combination affected the foreign commerce of this country"); *United States v. Aluminum Co. of America*, 148 F.2d at 444 ("intended to affect imports and exports [and] . . . is shown actually to have had some effect on them"); *United States v. Imperial Chem. Indus., Ltd.*, 100 F. Supp. 504, 592 (S.D.N.Y. 1951) ("a conspiracy . . . which affects American commerce"); *United States v. Timken Roller Bearing Co.*, 83 F. Supp. 284, 309 (N.D. Ohio 1949) ("a direct and influencing effect on trade"), *modified and aff'd*, 341 U.S. 593 (1951).

Different standards have been urged by other commentators. For example, James Rahl turns away from a flat effects requirement by concluding that the Sherman Act should reach a restraint either (1) if it occurs in the course of foreign commerce, or (2) if it substantially affects either foreign or interstate commerce. Rahl, *Foreign Commerce Jurisdiction of the American Antitrust Laws*, 43 ANTITRUST L.J. 521, 523 (1974). Thus, in essence, as Rahl observes, "[t]here is no agreed black-letter rule articulating the Sherman Act's commerce coverage" in the international context. *Id.* See also *Timberlane*, 549 F.2d at 610-11.

7 See cases cited in note 5 *supra*. But see *Sage Int'l, Ltd. v. Cadillac Gage Co.*, 534 F. Supp. 896 (E.D. Mich. 1981); *Williams v. Curtiss-Wright Corp.*, 694 F.2d 300 (3d Cir. 1982).

*Corp.*⁸ and *Sage International, Ltd. v. Cadillac Gage Co.*,⁹ illustrate the divergent approaches to this problem. The *Clayco* court adopted a mechanical approach, applying the doctrine without considering the need to do justice among the litigants.¹⁰ This approach allows defendants the shield of the act of state doctrine even where corruption is involved.¹¹ In contrast, the *Sage* court advocated balancing the need to do justice among the litigants against the need to promote the policy concerns underlying the act of state doctrine.¹² This approach permits a "corruption exception" to the act of state doctrine: the justice achieved by examining an allegedly corrupt act of a foreign official outweighs the possible harmful effects on foreign relations.

Part I of this comment examines the policy concerns underlying the act of state doctrine. Part II, focusing on the *Sage* and *Clayco* opinions, examines recent judicial treatment of the doctrine in the area of international antitrust. Part III suggests that the *Sage* court presents the better approach because it considers the totality of circumstances in determining whether to apply the act of state doctrine within the context of international antitrust.

I. Policy Concerns Underlying the Act of State Doctrine

The judicially-created act of state doctrine precludes American courts, both state and federal, from reviewing the validity of a recognized foreign sovereign's public acts committed within the foreign territory.¹³ The Supreme Court has held that the doctrine is not constitutionally based, but rather, is based upon policy considerations of international comity and separation of powers.¹⁴ Generally, the international comity and separation of powers considerations reflect one policy goal: that the United States maintain a strong foreign relations position expressed in a singly-voiced foreign policy.¹⁵

Although some commentators suggest that the act of state doc-

8 712 F.2d 404 (9th Cir. 1983).

9 534 F. Supp. 896 (E.D. Mich. 1981).

10 See notes 64-89 *infra* and accompanying text.

11 See Note, *Sherman Act Jurisdiction and the Acts of Foreign Sovereigns*, 77 COLUM. L. REV. 1247, 1261 (1977).

12 See notes 37-63 *infra* and accompanying text.

13 See note 1 *supra*.

14 See *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. at 423, where the Court stated: "The text of the Constitution does not require the act of state doctrine; it does not irrevocably remove from the judiciary the capacity to review the validity of foreign acts of state."

15 See Note, *Judicial Balancing of Foreign Policy Considerations: Comity and Errors Under the Act of State Doctrine*, 35 STAN. L. REV. 327, 341-42 (1983).

trine may have existed even earlier, the doctrine first appeared in England in the 1674 case of *Blad v. Bamfield*.¹⁶ In 1897, Chief Justice Fuller, speaking for a unanimous court in *Underhill v. Hernandez*,¹⁷ penned the classic American statement of the doctrine: "Every sovereign state is bound to respect the independence of every other sovereign state, and the courts of one country will not sit in judgment on the acts of the government of another, done within its own territory."¹⁸

Through this statement, the Supreme Court also established the underlying policy of the act of state doctrine as one of international comity—respect for foreign sovereigns. In the following years, the Supreme Court reiterated this policy basis for applying the doctrine.¹⁹ Then, in 1964, the Supreme Court in *Banco Nacional de Cuba v. Sabbatino*²⁰ recharacterized the policy basis for the act of state doctrine as that of separation of powers:

The act of state doctrine . . . arises out of the basic relationships between branches of government in a system of separation of powers. It concerns the competency of dissimilar institutions to make and implement particular kinds of decisions in the area of international relations.²¹

Thus, the Court established a modern basis for the doctrine in the inherent constitutional principle of separation of powers, rather than in notions of comity. Since *Sabbatino*, several lower courts have followed the Supreme Court's emphasis on a separation of powers rationale.²² Judicial concern in these cases has shifted from avoiding an affront to foreign sovereigns (international comity) to avoiding interference with the executive branch.

Although courts seem to consider the separation of powers rationale distinct from the comity rationale, the two are inherently interrelated and the distinction merely one of form, not substance. Comity considerations dictate against an adjudication in which the

16 3 Swanst 604, 36 Eng. Reprint 992 (1674).

17 168 U.S. 250 (1897). See Note, *supra* note 15, at 341-42.

18 *Id.* at 252.

19 See, e.g., *Oetjen v. Central Leather Co.*, 246 U.S. 297 (1918); *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1909).

20 376 U.S. 398 (1964).

21 *Id.* at 423.

22 See, e.g., *Banco Nacional de Cuba v. First Nat'l City Bank*, 431 F.2d 394, 397-98 (2d Cir. 1970), *rev'd on other grounds*, 406 U.S. 759 (1972); *International Ass'n of Machinists v. OPEC*, 649 F.2d 1354, 1359 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982); *Ethiopian Spice Extraction Share Co. v. Kalamazoo Spice Extraction Co.*, 543 F. Supp. 1224, 1228-29 (W.D. Mich. 1982).

judicial branch affronts a foreign sovereign and thus weakens the executive branch's efforts to carry on foreign relations with that sovereign. This interrelationship between the two rationales is actually apparent in the *Underhill* opinion.²³ Although *Underhill* is usually quoted as the classic statement of the comity rationale, the Supreme Court also addressed the separation of powers rationale: "Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves [i.e., diplomacy which is typically the responsibility of the executive branch]."²⁴

Essentially, then, the courts apply the act of state doctrine based on the considerations of international comity and separation of powers. These concerns reflect the more fundamental concern that the United States maintain a strong foreign relations position free from judicial branch adjudications which offend foreign sovereigns and interfere with the foreign policy of the executive branch.

II. A Developing Corruption Exception

In applying the act of state doctrine to the facts of specific cases, federal courts have carved out several exceptions to the doctrine's basic rule requiring acceptance without question of the validity of a foreign sovereign's act.²⁵ Significantly, these exceptions generally arise only in situations where application of the doctrine would not serve its underlying policy. The two most notable exceptions are the commercial acts exception and the Bernstein exception.²⁶

The Supreme Court first enunciated the commercial acts exception to the act of state doctrine in *Alfred Dunhill of London, Inc. v. Republic of Cuba*.²⁷ In *Dunhill*, Justice White, writing for the majority, stated that the act of state doctrine should not apply to foreign sovereign acts which are commercial and not governmental in nature. Judicial review of commercial acts, commented Justice White, would not create the international problems likely to ensue from review of

23 168 U.S. 250, 252 (1897).

24 *Id.*

25 See, e.g., *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976) (commercial acts exception); *Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*, 173 F.2d 71 (2d Cir. 1949), *modified*, 210 F.2d 375 (2d Cir. 1954) (Bernstein exception).

26 For a good discussion of these and other exceptions to the act of state doctrine, see Comment, *The Act of State Doctrine: A History of Judicial Limitations and Exceptions*, 18 HARV. INT'L L.J. 677 (1977).

27 425 U.S. 682 (1976).

public governmental acts.²⁸ The Bernstein exception emerged from a series of cases in which individuals sought compensation for Nazi expropriations prior to World War II.²⁹ Under the Bernstein exception, a court would not invoke the act of state doctrine if the executive branch advised the court that foreign relations considerations did not necessitate application of the doctrine.³⁰ Critics of the Bernstein exception complain that it inhibits the independence of the judiciary and that adherence to the doctrine fails to recognize that avoidance of conflict with the executive branch is only one of the bases of the doctrine.³¹ The Supreme Court cast serious doubt on the future of the Bernstein exception in *First National City Bank v. Banco Nacional de Cuba*,³² where only three justices found the exception dispositive of the case,³³ and the six others specifically criticized the exception.³⁴

In addition to these established exceptions, several federal courts have recently considered a new exception: a corruption exception. Two recent cases, *Sage International, Ltd. v. Cadillac Gage Co.*³⁵ and *Clayco Petroleum Corp. v. Occidental Petroleum Corp.*,³⁶ present the two distinct approaches courts have taken on a new corruption exception to the act of state doctrine.

A. Sage International, Ltd. v. Cadillac Gage Co.

The United States District Court for the Eastern District of Michigan, in *Sage International, Ltd. v. Cadillac Gage Co.*, chose not to follow a broad interpretation of the act of state doctrine. Instead, the court chose to balance the policy concerns underlying the doctrine with the possibility of injury to the individual parties.³⁷ In *Sage*, a United States corporation, Sage International, Ltd., claimed that another United States corporation, Cadillac Gage Company, had violated sections one and two of the Sherman Antitrust Act by

28 *Id.* at 698.

29 *See* *Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*, 173 F.2d 71 (2d Cir. 1949), *modified*, 210 F.2d 375 (2d Cir. 1954). *See also* *Bernstein v. Van Heyghen Freres Societe Anonyme*, 163 F.2d 246 (2d Cir. 1947).

30 *See* Comment, *supra* note 26, at 688-91.

31 *Id.* at 691.

32 406 U.S. 759 (1972).

33 *Id.* at 765-68.

34 *Id.* at 772-73 (Douglas, J., concurring), 773 (Powell, J., concurring), 782-93 (Brennan, J., dissenting).

35 534 F. Supp. 896 (E.D. Mich. 1981).

36 712 F.2d 404 (9th Cir. 1983).

37 534 F. Supp. at 908-10.

unlawfully instituting "sham" litigation and by participating in an illegal kickback scheme to prevent Sage from entering the armored car market in fifteen foreign countries.³⁸ Sage sued to recover damages for loss of income caused by its exclusion from the market.³⁹ Cadillac Gage moved for partial summary judgment to dismiss Sage's claim for market damages,⁴⁰ asserting that the act of state doctrine barred inquiry into the foreign governments' reasons for buying the Cadillac Gage armored cars rather than Sage cars.⁴¹ Cadillac Gage argued that Sage therefore could not establish the causal link between the defendant's acts and the injury.⁴² After a lengthy discussion of the act of state doctrine as it applies to antitrust cases, the Michigan district court denied Cadillac Gage's motion for partial summary judgment, concluding that the act of state doctrine did not preclude Sage from proving its claims.⁴³

The *Sage* court first considered the Second Circuit's opinion in *Hunt v. Mobil Oil Corp.*⁴⁴ In *Hunt*, the Second Circuit applied the act of state doctrine to an antitrust suit by an independent oil producer, Hunt, against the seven major oil companies.⁴⁵ The *Hunt* court equated inquiring into the motivation for Libya's acts with challenging the validity of those acts.⁴⁶ The *Hunt* court posited no other rea-

38 *Id.* at 898.

39 *Id.*

40 *Id.*

41 *Id.*

42 *Id.*

43 *Id.* at 911.

44 550 F.2d 68 (2d Cir. 1977), *cert. denied*, 434 U.S. 984 (1978).

45 *Id.* at 72-73. Hunt alleged that the oil companies had conspired to retain a competitive advantage of Persian crude oil over Libyan crude by precipitating the Libyan government's nationalization of Hunt's oil fields. *Id.* at 72. Due to the increased demands by OPEC and the Libyan government, the seven major oil companies and the independent producers agreed that all producers would share in any cutback in oil production required by any government, and that Persian Gulf producers would supply Libyan producers with oil to meet their contractual obligations if government restrictions caused a shortage of Libyan oil. *Id.* at 71. In 1971, Libya nationalized part of the Sarir Field and told Hunt to market the oil for Libya. Relying upon the producer's agreement, Hunt acceded to the major oil companies' request and refused Libya's demand. *Id.* Hunt's refusal to this demand and subsequent demands led Libya to nationalize Hunt's interest in the Sarir Field. *Id.* at 72. Hunt claims that the seven major oil companies conspired through the producer's agreement to preserve their competitive advantage in Persian crude oil by eliminating producers of Libyan crude. *Id.*

46 *Id.* at 77. The *Hunt* court stated:

[W]e cannot logically separate Libya's motivation from the validity of its seizure. The American judiciary is being asked to make inquiry into the subtle and delicate issue of the policy of a foreign sovereign, a Serbonian Bog, precluded by the act of state doctrine as well as the realities of the fact finding competence of the court in an issue of far reaching national concern.

Id.

sons for concluding that the act of state doctrine applied.⁴⁷ The *Sage* court, however, rejected the *Hunt* court's equation of inquiry into the foreign government's motivation with inquiry into the validity of a foreign government's act.⁴⁸

The *Sage* court next examined the Ninth Circuit's rationale in *Timberlane Lumber Co. v. Bank of America*.⁴⁹ In *Timberlane*, Timberlane Lumber Co., a United States corporation, sued a United States bank and the bank's Honduran subsidiary for antitrust violations.⁵⁰ The Bank of America moved to dismiss based on the act of state doctrine. The district court dismissed the action,⁵¹ but the court of appeals vacated the dismissal and remanded the case.⁵² The Ninth Circuit's discussion focused on extraterritorial jurisdiction under antitrust laws, but the court addressed act of state doctrine concerns and injected foreign policy concerns into its analysis of extraterritorial jurisdiction.⁵³ The *Timberlane* court formulated a tripartite analysis⁵⁴ to be used and a list of elements⁵⁵ to be weighed in determining whether to assert extraterritorial jurisdiction. Although the

47 *Id.* at 76-78.

48 *Sage*, 534 F. Supp. at 905.

49 549 F.2d 597 (9th Cir. 1976).

50 *Id.* at 601. Timberlane claimed that Bank of America officials had conspired with Honduran officials to keep control of the Honduran lumber export business in the hands of a group of individuals financed and controlled by the bank. *Id.* Timberlane alleged that officials of Bank of America and officials of the bank's Honduran subsidiary conspired to prevent Timberlane from milling lumber through Timberlane's Honduran subsidiary and exporting the lumber to the United States. *Id.*

51 The district court dismissed under the act of state doctrine and for lack of subject matter jurisdiction. *Id.*

52 *Id.* at 615. The *Timberlane* court remanded for determination of whether any conflict with Honduran law or policy existed and for analysis of the relative interests of the United States and Honduras. *Id.* In vacating the dismissal, the court emphasized that the sovereign acts complained of were judicial proceedings, that Timberlane did not name any Honduran government official as a co-conspirator or defendant, that Timberlane did not challenge any Honduran law or policy in a way that would threaten relations between Honduras and the United States, and that there was no indication that the Honduran court's actions reflected a sovereign decision to interfere with Timberlane's lumber mill. *Id.* at 608.

53 *Id.* at 605-08, 613.

54 *Id.* at 615. The three steps included:

[1] Does the alleged restraint affect, or was it intended to affect, the foreign commerce of the United States? [2] Is it of such a type and magnitude so as to be cognizable as a violation of the Sherman Act? [3] As a matter of international comity and fairness, should the extraterritorial jurisdiction of the United States be asserted to cover it?

Id.

55 *Id.* at 614. The *Timberlane* court listed the following factors:

(1) the degree of conflict with foreign law or policy,
(2) the nationality or allegiance of the parties and the locations or principal places of business of corporations,

Timberlane court was addressing a jurisdictional issue, the analysis and the factors listed similarly apply in determining whether the act of state doctrine precludes judicial review of an antitrust case by an American court.⁵⁶ The *Sage* court expressly approved the *Timberlane* court's analysis and elements: "[T]he availability of the act of state defense hinges on policy considerations that are best accounted for by attention to the kinds of factors identified in *Timberlane*. . . ."⁵⁷

(3) the extent to which enforcement by either state can be expected to achieve compliance,

(4) the relative significance of effects on the United States as compared with those elsewhere,

(5) the extent to which there is explicit purpose to harm or effect American commerce,

(6) the foreseeability of such effect, and

(7) the relative importance to the violations charged of conduct within the United States as compared with conduct abroad. A court evaluating these factors should identify the potential degree of conflict if American authority is asserted.

Id. (footnote omitted).

56 The *Timberlane* court explicitly linked an extraterritorial jurisdiction analysis with an act of state doctrine analysis. The court stated: "The act of state doctrine discussed earlier demonstrates that the judiciary is sometimes cognizant of the possible foreign relations implications of its action. Similar awareness should be extended to the general problems of extraterritoriality." *Id.* at 613. In addition, the court noted that "[o]nly respect for the role of the executive and for international notions of comity and fairness limit [the] constitutional grant" of congressional power to regulate foreign commerce. *Id.* at 612. These same two policy concerns underlie the act of state doctrine. *See* note 14 *supra* and accompanying text.

57 *Sage*, 534 F. Supp. at 905. The *Sage* court also cited with approval the modifications of the *Timberlane* factors made by the Third Circuit in *Mannington Mills v. Congoleum Corp.*, 595 F.2d 1287 (3d Cir. 1979). In *Mannington Mills*, the Third Circuit adopted the *Timberlane* approach and modified the list of factors used in the balancing formulation. *Id.* at 1297. The *Mannington* court lists the factors as:

(1) degree of conflict with foreign law or policy;

(2) nationality of the parties;

(3) relative importance of the alleged violation of conduct here compared to that abroad;

(4) availability of a remedy abroad and the pendency of litigation there;

(5) existence of intent to harm or affect American commerce and its foreseeability;

(6) possible effect upon foreign relations if the court exercises jurisdiction and grants relief;

(7) if relief is granted, whether a party will be placed in the position of being forced to perform an act illegal in either country or be under conflicting requirements by both countries;

(8) whether the court can make its order effective;

(9) whether an order for relief would be acceptable in this country if made by the foreign nation under similar circumstances; and

(10) whether a treaty with affected nations has addressed the issue.

Id. at 1297-98 (footnote omitted). The *Mannington* court noted that "to determine whether the act of state doctrine applies in a given factual context, the court must analyze the nature of the questioned conduct and the effect upon the parties in addition to appraising the sovereign's role." *Id.* at 1293.

The *Sage* court also cited several other cases where courts used the *Timberlane* approach instead of the *Hunt* approach.⁵⁸ The court argued that in these antitrust cases, the Supreme Court focused on broad policy concerns that the *Hunt* court ignored.⁵⁹ The *Sage* court thus denied Cadillac Gage's motion for partial summary judgment,⁶⁰ stating that "it cannot be concluded that foreign relations considerations preponderate heavily against adjudication of Plaintiffs' claims in this case."⁶¹

After applying the *Timberlane* factors to the facts of the case, the *Sage* court turned its consideration to a corruption exception to the act of state doctrine. Mentioning a possible relationship between a corruption exception and the Foreign Corrupt Practices Act,⁶² the court suggested that a "likelihood" exists that the act of state doctrine would not apply if the case had involved charges of corruption relating to the acts of a foreign government.⁶³

B. *Clayco Petroleum Corp. v. Occidental Petroleum Corp.*

In *Clayco Petroleum Corp. v. Occidental Petroleum Corp.*,⁶⁴ the Ninth Circuit adopted a mechanical approach in considering a possible corruption exception to the act of state doctrine. Although the *Clayco* court considered *Timberlane's* more flexible balancing approach, it ultimately followed the *Hunt* court's reasoning, which mechanically focused on whether the validity of the foreign sovereign's acts was challenged in any way.⁶⁵

In *Clayco*, Clayco Petroleum Corporation sued under the Sherman Act, claiming that Occidental Petroleum Corporation had conspired to bribe the Sheikh of Umm Al Qaywayn⁶⁶ to break an agreement with Clayco and give an oil and gas concession to Occidental's subsidiary.⁶⁷ The district court granted Occidental's motion

58 The *Sage* court cited *Industrial Invest. Dev. Corp. v. Mitsui & Co.*, 594 F.2d 48 (5th Cir. 1979), *cert. denied*, 445 U.S. 903 (1980), and *Mannington Mills*, 595 F.2d 1287.

59 *Sage*, 534 F. Supp. at 903-04.

60 *Id.* at 908-09, 911.

61 *Id.* at 909.

62 The Foreign Corrupt Practices Act prohibits bribery of foreign officials. 15 U.S.C. §§ 78dd-1 to 78ff (Supp. V 1981). See text accompanying notes 81-83 *infra*.

63 *Sage*, 534 F. Supp. at 910.

64 712 F.2d 404 (9th Cir. 1983), *cert. denied*, 52 U.S.L.W. 3509 (U.S. Jan. 9, 1984) (No. 83-546).

65 *Id.* at 407. See notes 44-47 *supra* and accompanying text.

66 Umm Al Qaywayn, formerly one of the Trucial States, is now part of the United Arab Emirates.

67 712 F.2d at 405.

to dismiss for failure to state a claim, based on the act of state doctrine.⁶⁸ The district court decided that a determination of causation would necessitate reviewing the validity of the Sheikh's acts in relation to Occidental and that the act of state doctrine barred such an inquiry.⁶⁹

The Ninth Circuit agreed with the district court's analysis and affirmed the dismissal.⁷⁰ The court examined both of Clayco's arguments: (1) that the case fell outside the act of state doctrine, and (2) that the commercial acts or corruption exception applied.⁷¹ Clayco first argued that the alleged secret bribery and subsequent award of an oil concession did not represent a sovereign policy decision and were therefore outside the scope of the act of state doctrine.⁷² The court began its analysis of this argument by distinguishing the case from both *Timberlane*⁷³ and *Mannington Mills v. Congoleum Corp.*⁷⁴ The *Clayco* court said that in these two cases, "sovereign activity merely formed the background to the dispute or . . . the only governmental actions were the neutral application of the laws."⁷⁵ However, in the case before it, the *Clayco* court found that because the underlying dispute involved a sovereign decision about the allocation of national resources, the act of state doctrine precluded judicial review.⁷⁶

The court next considered Clayco's alternative argument that the act of state doctrine forbids inquiry into the validity of the foreign government's acts and not into the foreign government's motivation for a decision; thus, the doctrine did not apply.⁷⁷ The *Clayco* court rejected this argument, stating that the foreign sovereign would be equally embarrassed by an inquiry into its motivation for granting the concession as by an inquiry into the validity of the concession

68 *Id.* at 406.

69 *Id.*

70 *Id.* at 405.

71 *Id.* at 406. The court summarily rejected Clayco's commercial acts exception argument. See note 80 *infra*.

72 712 F.2d at 406.

73 549 F.2d 597 (9th Cir. 1976).

74 595 F.2d 1287 (3d Cir. 1979).

75 712 F.2d at 406.

76 *Id.* at 407.

77 Clayco argued that Occidental's act of state doctrine defense should fail because the court would only be looking at the foreign sovereign's motivation and would not be assessing the legal validity of the sovereign's act. The appellants relied on a statement by the United States Court of Appeals for the Fifth Circuit that "motivation and validity are not 'equally protected by the act of state doctrine.'" *Id.* at 407 (*quoting* Industrial Invest. Dev. Corp. v. Mitsui & Co., 594 F.2d 48, 55 (5th Cir. 1979), *cert. denied*, 445 U.S. 903 (1980)).

itself, especially if Clayco alleged that the motivation was bribery.⁷⁸ The court explicitly stated that the act of state doctrine prevented a court from inquiring into the motivation for a foreign government's conduct.⁷⁹

After concluding that the act of state doctrine applied, the court then considered whether a corruption exception allowed the court to hear the case.⁸⁰ Clayco's argument for a corruption exception centered upon the Foreign Corrupt Practices Act of 1977 (FCPA).⁸¹ The FCPA prohibits domestic corporations from bribing foreign officials to attain business ends.⁸² The FCPA grants a cause of action to the government, providing for criminal penalties and civil injunction of an impending violation; however, the FCPA does not grant private citizens any similar cause of action.⁸³ Clayco argued that, by passing the FCPA, Congress indicated that stemming bribery of foreign officials outweighs any possible embarrassment to foreign governments or any potential harm to foreign relations.⁸⁴

The court of appeals agreed that the act of state doctrine would not bar FCPA suits brought by the government⁸⁵ but concluded that the doctrine would still prevent suits by private citizens even if they alleged corrupt behavior.⁸⁶ In reaching this conclusion, the court emphasized that under the FCPA, the executive branch decides

78 The *Clayco* court stated that "the very existence of plaintiffs' claim depends upon establishing that the motivation for the sovereign act was bribery, thus embarrassment would result from adjudication." 712 F.2d at 407.

79 *Id.* at 408. The *Clayco* court said, "Appellants . . . cannot argue that inquiry into motivation [for the Sheikh's acts] in this case is unprotected [by the act of state doctrine]." *Id.* The court also referred with approval to *Occidental Petroleum Corp. v. Buttes Gas & Oil Co.*, 331 F. Supp. 92 (C.D. Cal. 1971), *aff'd*, 461 F.2d 1261 (9th Cir.), *cert. denied*, 409 U.S. 950 (1972). The *Clayco* court said that it adopted the *Buttes* court's holding that the act of state doctrine precludes judicial scrutiny of the motivation for foreign sovereign acts. The *Clayco* court also adopted the *Buttes* court's comment that the doctrine traditionally barred antitrust claims based on the defendant's alleged inducement of foreign action. 712 F.2d at 407.

80 The appellants also argued that the commercial acts exception to the act of state doctrine applied. The court of appeals quickly dispensed with this argument and focused on the appellants' corruption exception argument. 712 F.2d at 408.

81 15 U.S.C. §§ 78dd-1 to 78ff (Supp. V 1981).

82 *Id.* §§ 78dd-1, 78dd-2.

83 *Id.* §§ 78dd-1, 78dd-2(b), 78dd-2(c), 78ff.

84 712 F.2d at 408-09. Clayco argued that the FCPA implicitly created a corruption exception to the act of state doctrine. Clayco contended that by passing the FCPA, Congress indicated its intention to abrogate the act of state doctrine in private suits involving bribery of a sovereign foreign government. *Id.*

85 The FCPA grants enforcement authority to both the United States Department of Justice and the Securities Exchange Commission. *Id.* at 409.

86 The court stated: "[I]n private suits, the act of state doctrine remains necessary to protect the proper conduct of national foreign policy." *Id.*

which cases to bring and any enforcement action therefore "represents a judgment on the wisdom of bringing a proceeding, in light of the exigencies of foreign affairs."⁸⁷ On the other hand, the court distinguished private suits from government actions, saying that suits by private citizens would not undergo this screening process and thus would not reflect an executive branch decision to risk offending a foreign government.⁸⁸ The court of appeals therefore concluded that the FCPA had not abrogated the act of state doctrine and refused to recognize a corruption exception to the doctrine for private lawsuits.⁸⁹

III. The Validity of the *Sage* and the *Clayco* Positions

The act of state doctrine is policy oriented,⁹⁰ and any approach to the doctrine should recognize this orientation. The *Sage* court's balancing test,⁹¹ which weighs the need to do justice against the risk to the United States' foreign relations position, comports more with the spirit of the doctrine than the *Clayco* court's inflexible, mechanical approach.⁹² Also, as a policy doctrine, the act of state doctrine lends itself to court discretion and a case-by-case analysis that a balancing test requires. Although courts must tread carefully in this sensitive area, by using the *Sage* balancing test they would have the flexibility necessary to resolve disputes involving the act of state doctrine without jeopardizing the underlying policy.

The *Sage* balancing approach also provides courts with the flexibility needed to weigh the policy concerns underlying the act of state doctrine against the demands of justice to have the claim heard. The *Sage* court's analysis has particular appeal when parties are domestic corporations and decision of the case would require only a tangential inquiry into a foreign government's acts. The *Clayco* court's mechanical approach would allow domestic corporate defendants to shield their actions from review simply by implicating a foreign government in the scheme.⁹³ *Clayco*'s mechanical application of the doc-

87 *Id.*

88 *Id.*

89 *Id.*

90 See notes 13-24 *supra* and accompanying text.

91 See note 57 *supra* and accompanying text.

92 *Sage*, 534 F. Supp. at 900.

93 In *Sage*, after concluding that the act of state doctrine did not bar plaintiff's claims, the district court commented that "[i]n this case involving allegations largely related to domestic actions of the Defendant, invocation of the Act of State Doctrine would be to raise a shield made available simply because Defendant has joined foreign sovereign purchasing acts into its alleged antitrust conspiracy against Plaintiffs." 534 F. Supp. at 911. See also Williams v.

trine, while providing a degree of certainty, is impractical and can lead to unjust results in circumstances where the risk to international comity and the conduct of foreign affairs is minimal.

Furthermore, a *per se* rule like that enunciated in *Hunt* and *Clayco* stresses semantics and technical concerns instead of the policy bases of the act of state doctrine. A mechanical approach narrowly focuses on the single issue of whether a foreign sovereign's act is challenged instead of considering the effect of judicial review on the United States' foreign relations position. Using a mechanical approach, once a court finds a foreign sovereign's act challenged in any way, the court implements an irrebuttable presumption that the challenge will damage United States' foreign policy and disturb the separation of powers. By using a *per se* approach when many competing interests are involved, the entire outcome of a complex case hinges on only one technical determination. A court, focusing on a single factor, may lose sight of the whole picture, and, consequently, of the aim of the act of state doctrine: to ensure that the judiciary does not jeopardize the ability of the United States to have a singly-voiced foreign policy. A court could forego justice in a particular case even when the policy bases of the doctrine are not actually threatened.

A corruption exception to the act of state doctrine, as suggested by the *Sage* court, would give both parties the opportunity to be heard and would give the court the opportunity to do justice in cases involving allegations of corrupt practices.⁹⁴ Without a corruption exception, the act of state doctrine permits parties engaging in corrupt practices to obtain a windfall by hiding behind the doctrine. A court should feel free to balance the need to do justice against the risk of weakening the United States' foreign relations position, a risk created by the possibility that adjudication will offend a foreign sovereign or interfere with the executive branch's handling of foreign affairs.

Naturally, a court's inquiry, based on a corruption exception, into the motivation behind a foreign sovereign's act, involves a risk of offending a foreign sovereign. However, that risk should be slight if the court focuses not on the sovereign's acts, but rather on the domestic corporation's acts which touch on the sovereign's acts only indirectly. Indeed, the court would have no reason to evaluate the

Curtiss-Wright Corp., 694 F.2d 300, 304 n.5 (3d Cir. 1982) ("The broad statement in *Hunt* that a court may never examine the motivation of foreign states has been criticized for immunizing the conduct of private defendants who involve a foreign government in their anti-competitive schemes.").

94 See *Curtiss-Wright*, 694 F.2d at 303-04.

validity of the sovereign's acts. The court would merely evaluate how those acts affect the domestic corporation's liability. For example, in a case where a domestic corporation bribes a foreign official in order to receive an oil concession, if the court applied a corruption exception, the court would not invalidate the award of the oil concession. The court would merely assess the corporation's liability for its anticompetitive activity in obtaining the oil concession.

Finally, although the legislative history of the FCPA does not support a private cause of action under the FCPA,⁹⁵ a corruption exception would nevertheless advance the spirit of the FCPA and Congress' goal of stemming bribery by domestic corporations abroad.⁹⁶ A corruption exception would not abrogate the act of state doctrine in all cases involving allegations of corruption. Instead, using the *Sage* balancing approach to assess whether to apply a corruption exception would result in a case-by-case analysis which would screen out private lawsuits where the policy concerns underlying the act of state doctrine are particularly strong.

IV. Conclusion

Considering the policies underlying the act of state doctrine, a balancing test is a more appropriate approach than an inflexible *per se* rule.⁹⁷ The *Clayco* court, while paying lip-service to the need for flexibility,⁹⁸ applied a mechanical approach which ignores the policy considerations underlying the doctrine. When applying a balancing test, the courts would weigh the need to do justice among the litigants against the need to promote the policy concerns underlying the doctrine. And, in balancing these competing interests, the *Sage* factors⁹⁹ would guide the courts in determining whether the act of state doctrine applies.

Although the *Sage* approach represents a more reasoned view in this sensitive area, no court has specifically adopted a corruption exception. Moreover, the *Clayco* decision specifically addressed and rejected a corruption exception.¹⁰⁰ However, while *Sage* did not explicitly adopt a corruption exception,¹⁰¹ the language of *Sage* is en-

95 See *Clayco*, 712 F.2d at 409.

96 See *Sage*, 534 F. Supp. at 910 n.26.

97 See *Curtiss-Wright*, 694 F.2d at 303-04.

98 712 F.2d at 406.

99 See note 57 *supra* and accompanying text.

100 712 F.2d at 409.

101 Rather, the *Sage* court only mentioned that support exists for such an exception. 534 F. Supp. at 909-10 & n.26.

couraging. Thus, although a corruption exception to the act of state doctrine does not exist at the present time, the ground has been broken. And, given the policy concerns of the act of state doctrine and the *Sage* balancing test for guidance, the courts have a few building blocks to begin a foundation for a corruption exception.

Maureen A. Dowd
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SECURITIES LAW—SUBJECT MATTER JURISDICTION IN TRANSNATIONAL SECURITIES FRAUD CASES: THE EXPANDING APPLICATION OF THE CONDUCT TEST

Plaintiff, a West German corporation, brings suit in federal district court alleging that defendants violated United States securities laws. Defendants, including a Swiss citizen and other foreign parties, claim that the transaction has no effect on American investors, and move to dismiss for lack of subject matter jurisdiction. Plaintiff cannot demonstrate that the alleged fraud produced any domestic impact, but maintains that federal court has jurisdiction because defendants committed fraudulent acts in the United States. Who will prevail on the motion?

This situation came before the United States Court of Appeals for the Ninth Circuit in *Grunenthal GmbH v. Hotz*.¹ In district court the defendants prevailed on their motion to dismiss.² Relying primarily on Second Circuit precedent,³ the district court refused to assert jurisdiction in the absence of any demonstrable effect on American investors.⁴ The court declined to follow the "more liberal approach"⁵ of those circuits which have based jurisdiction solely on fraudulent conduct in the United States.⁶

The Ninth Circuit reversed, however, holding that the absence of "effects" within the United States does not preclude extraterritorial application of the securities laws.⁷ The Ninth Circuit adopted

1 511 F. Supp. 582 (C.D. Cal. 1981). See notes 66-73 *infra* and accompanying text.

2 511 F. Supp. at 588.

3 *Id.* at 587. The district court found no controlling Ninth Circuit precedent but determined that proper analysis of the question would parallel that utilized by the Second Circuit. See notes 25-51 *infra* and accompanying text.

4 511 F. Supp. at 588. The district court ruled:

We hold, on these facts, that no subject matter jurisdiction exists; that neither the Securities Act of 1933 nor the Securities Exchange Act of 1934 applies to a transaction in foreign securities between foreign nationals and corporations which has no effect on any American investors or securities market and in which the only nexus with the United States is conduct in this country based on convenience

Id.

5 *Id.*

6 *Id.* The district court explicitly refers to *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979). See notes 52-65 *infra* and accompanying text.

7 *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983). The court of appeals stated: Our circuit has spoken infrequently on the topic of subject matter jurisdiction over transnational securities transactions. While we exercised jurisdiction in both of the

the conduct test, which the district court had rejected, and stated that its ruling was consistent with Second Circuit precedent.⁸

This comment examines whether the conduct test is consistent with Second Circuit holdings, and whether the test reflects a general trend in the law. Part I summarizes the basis for American jurisdiction over transnational securities fraud cases.⁹ Part II compares the approach taken by the Second Circuit with that of the Third, Eighth, and Ninth Circuits, concluding that the approaches are consistent. Finally, Part III suggests that *Grunenthal* reflects a trend in favor of asserting jurisdiction over foreign securities fraud cases solely on the basis of fraudulent conduct in the United States.

Ninth Circuit cases involving the extraterritorial application of securities laws because the transactions produced "effects" within the United States . . . we have never held that the absence of such effects precludes the exercise of jurisdiction or that conduct alone is not enough.

Id. at 424. See notes 66-73 *infra* and accompanying text.

8 The Ninth Circuit stated:

[C]onsistent with the established objectives of the federal securities laws, we have recognized that "the jurisdictional hook need not be large to fish for securities laws violations". . . . In our view, the test for subject matter jurisdiction formulated in the Eighth Circuit . . . best satisfies those objectives."

712 F.2d at 424. See notes 74-92 *infra* and accompanying text.

9 Many commentators discuss American jurisdiction over foreign securities fraud. Most generally support the recent expansion. Not all, however, would support the court of appeals' holding in *Grunenthal*. See Hacker & Rotunda, *The Extraterritorial Regulation of Foreign Business Under the U.S. Securities Laws*, 59 N.C.L. REV. 643 (1981) (including an extensive description of the principles underlying the expansion of American jurisdiction over foreign securities fraud and stating that such broad jurisdiction is particularly appropriate to the anti-fraud provisions of the Securities Acts); Johnson, *Application of Federal Securities Laws to International Securities Transactions*, 45 ALB. L. REV. 890 (1981) (describing, and generally commending, the recent expansion of federal jurisdiction; the author warns, however, against the "parochial application" of American laws to situations where the essential fraudulent conduct occurred abroad. *Id.* at 931); Note, *The Extraterritorial Application of the Anti-Fraud Provisions of the Securities Acts*, 11 CORNELL INT'L L.J. 136 (1978) (presenting the gradual development of American jurisdiction over transnational securities fraud and arguing that jurisdiction should be extended to pure conduct situations) [hereinafter cited as Note, *Extraterritorial Application*]; Note, *Extraterritorial Application of the Anti-Fraud Provisions of the Federal Securities Code: An Examination of the Role of International Law in American Courts*, 11 VAND. J. TRANSNAT'L L. 710 (1978) (describing the present doctrine and proposing that the Federal Securities Code will do much to clarify ambiguities) [hereinafter cited as Note, *Role of International Law*]; Sandberg, *The Extraterritorial Reach of American Economic Regulation: The Case of Securities Law*, 17 HARV. INT'L L.J. 315 (1976) (urging "judicial forbearance" through a conflict of laws approach); Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553 (1976) (which the Ninth Circuit in *Grunenthal* referred to when asserting jurisdiction on the basis of conduct) [hereinafter cited as Note, *American Adjudication*] (see notes 79-85 *infra* and accompanying text); Comment, *Transnational Reach of Rule 10b-5*, 121 U. PA. L. REV. 1363 (1973) (outlining the present judicially determined guidelines for the transnational application of the securities laws, and advocating greater participation by Congress and the SEC in determining jurisdictional limits) [hereinafter cited as Comment, *Transnational Reach*].

I. Basis for American Jurisdiction Over Foreign Securities Fraud

The Securities Act of 1933¹⁰ and the Securities Exchange Act of 1934¹¹ authorize securities fraud actions. Congress, however, in promulgating these acts, did not address their extraterritorial reach,¹² and the Securities Exchange Commission (SEC) has not clarified the issue.¹³ Instead, federal courts have had to determine the jurisdictional limits of United States securities laws.¹⁴ Initially, the courts hesitated to recognize jurisdiction over foreign securities fraud cases,¹⁵ probably due to the lack of clear Congressional intent, the possibility of international friction, and the drain upon judicial resources.¹⁶ The transformation of the national economy and the development of international capital markets, however, caused the federal courts to reconsider their position in order to maintain the effectiveness of United States securities laws.¹⁷

The touchstone for the general expansion of federal jurisdiction over foreign securities fraud has been the territorial principle of international law.¹⁸ This doctrine rests upon the premise that a sovereign has jurisdiction over all activity that occurs within its territorial boundary or that affects its citizens.¹⁹ When a court asserts jurisdiction over a controversy based on domestic impact, it employs the objective territorial principle, or "effects" test.²⁰ When, on the other

10 15 U.S.C. § 77a-77mm (1976).

11 15 U.S.C. § 78a-78hh-I (1970).

12 See generally Note, *Extraterritorial Application*, *supra* note 9, at 137-38; Sandberg, *supra* note 9, at 317-18; Note, *American Adjudication*, *supra* note 9, at 553-54; Johnson, *supra* note 9, at 900; Note, *Role of International Law*, *supra* note 9, at 710-13; Comment, *Transnational Reach*, *supra* note 9, at 1368-90. See also *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 416 (8th Cir. 1979).

13 See generally Hacker & Rotunda, *supra* note 9, at 670-73.

14 *Id.*

15 *Id.*

16 *Id.*

17 See generally Note, *Extraterritorial Application*, *supra* note 9, at 137-38; Sandberg, *supra* note 9, at 317-18; Note, *American Adjudication*, *supra* note 9, at 553-54; Johnson, *supra* note 9 at 900; Note, *Role of International Law*, *supra* note 9, at 710-13; Comment, *Transnational Reach*, *supra* note 9, at 1368-90. See also *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 416 (8th Cir. 1979).

18 See Hacker and Rotunda, *supra* note 9, at 670-73; Johnson, *supra* note 9, at 900-01.

19 See Hacker and Rotunda, *supra* note 9, at 670-73.

20 See Johnson, *supra* note 9, at 900-01. The objective territorial principle may be stated as follows:

A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside the territory and causes an effect within the territory if either (1) the conduct and its effect are generally recognized as constitutional elements of a crime or tort under the law of states that have reasonably developed legal systems; or (b) (i) the conduct and its effect are constitutional elements of activity to

hand, a court exercises jurisdiction based on wrongful conduct occurring within the territory, it uses the subjective territorial principle, or "conduct" test.²¹

II. Circuit Court Application of the Conduct Test

Federal courts uniformly recognize jurisdiction over securities fraud cases that involve both conduct and effects within the United States.²² However, while the Third, Eighth, and Ninth Circuits have exercised jurisdiction in cases involving only conduct in the United States,²³ the Second Circuit has been reluctant to assert jurisdiction in the absence of a measurable effect on American investors.²⁴

A. *The Second Circuit*

The Second Circuit has on several occasions addressed the question of whether jurisdiction could be based on conduct in the United States.²⁵ In *Leasco Data Processing Equip. Corp. v. Maxwell*,²⁶ American plaintiffs brought suit against foreign defendants for securities fraud violations.²⁷ Plaintiffs claimed that the parties signed a contract in

which the rule applies; (ii) the effect within its territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems.

RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 18 (1965).

21 The Restatement sets forth the subjective territorial principle as follows:

A state has jurisdiction to prescribe a rule of law

(a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and

(b) relating to a thing located, or a status of other interest localized in its territory.

Id. § 17. See also Johnson, *supra* note 9, at 900-01; Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 415 n.8, 417 n.12 (8th Cir. 1979).

22 The discussion which follows focuses on the assertion of jurisdiction based solely on conduct within the United States. Courts have also exercised jurisdiction, however, based solely on effects within the United States, where all activities relating to a fraudulent transaction occurred outside the United States. See Shoenbaum v. Firstbrook, 405 F.2d 200, *modified on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom.* Manley v. Shoenbaum, 395 U.S. 906 (1969).

23 See notes 53-73 *infra* and accompanying text.

24 See notes 25-51 *infra* and accompanying text.

25 *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 1001 (2d Cir. 1975); *IIT v. Vencap*, 519 F.2d 1001 (2d Cir. 1975); *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980).

26 468 F.2d 1326 (2d Cir. 1972).

27 *Id.* at 1330-33. *Leasco*, a New York corporation, alleged that defendant *Maxwell*, a British citizen, violated section 10(b) of the Securities Exchange Act and Rule 10b-5 by con-

New York and that defendant made misrepresentations in plaintiffs' New York offices.²⁸ The Second Circuit asserted jurisdiction on the basis of both conduct in the United States and effects on American plaintiffs.²⁹ The court found that the scales tip in favor of exercising jurisdiction when substantial misrepresentations are made in the United States.³⁰ The district court in *Grunenthal*, interpreting this position, inferred that conduct alone would not have been sufficient in *Leasco* to "tip the scales" in favor of asserting jurisdiction.³¹ *Leasco*, then, provided an early indication of the Second Circuit's emphasis on an effect requirement.

The Second Circuit more fully explored the limits of the conduct test in *Bersch v. Drexel Firestone, Inc.*,³² and its companion case, *IIT v. Vencap*.³³ In *Bersch*, the plaintiffs, including both American and foreign parties in a class action, brought suit against a foreign corporation for securities violations involving misrepresentation in prospectuses planned and drafted by American accountants and underwriters.³⁴ The court asserted jurisdiction over the defendants regarding the American plaintiffs' complaint, since these plaintiffs had demonstrated that defendants' conduct affected American investors.³⁵ However, the court determined that the alleged fraudulent

spiring to induce Leasco to purchase British corporate stock at a price in excess of its true value.

28 *Id.* The conduct in the United States also included telephone calls by defendant to plaintiff's representative in New York. *Id.*

29 *Id.* at 1337.

30 *Id.*

31 511 F. Supp. at 586 n.5.

32 519 F.2d 974 (2d Cir.), *cert. denied sub nom. Bersch v. Arthur Anderson & Co.*, 423 U.S. 1018 (1975).

33 519 F.2d 1001 (2d Cir. 1975).

34 519 F.2d at 978-81. This action was brought by a class of purchasers of common stock which has been sold pursuant to a public offering. Plaintiffs claimed that defendants largely organized the offering in the United States.

35 *Id.* at 991-93. The court asserted jurisdiction on behalf of resident Americans and Americans residing abroad. The court held that the anti-fraud provisions of the federal securities laws:

(1) Apply to losses from sales of securities to American residents in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and

(2) Apply to losses from sales of securities to American residents abroad if, but only if, acts . . . of material importance in the United States have significantly contributed thereto; but

(3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts . . . within the United States directly caused such losses.

Id. at 993. The court determined that defendants' acts within the United States significantly contributed to losses of American residents abroad, but did not directly cause losses to the foreign plaintiffs. *Id.* at 989.

transaction involving foreign plaintiffs and foreign defendants did not affect American investors or the American securities market and therefore denied jurisdiction regarding the foreign plaintiffs' complaint.³⁶ The court did consider hearing the foreign plaintiffs' claim on the basis of the conduct test,³⁷ but determined that the alleged fraudulent activities in America were not sufficiently direct or material to merit asserting jurisdiction.³⁸ Accordingly, the court dismissed the foreign plaintiffs from the class action.

Vencap involved primarily foreign plaintiffs and defendants.³⁹ The plaintiffs alleged that American attorneys representing the foreign parties in the United States had exchanged drafts of a fraudulent purchase agreement.⁴⁰ The Second Circuit stated that this conduct simply formalized negotiations conducted entirely overseas, and held that jurisdiction does not extend to preparatory activities when the bulk of the activity is performed outside the United States.⁴¹ The court further stated, however, that jurisdiction could be maintained if assets of defendant Vencap were intended to be used for the private benefit of defendants' American representatives.⁴² Such use of assets would provide enough domestic impact to trigger the assertion of subject matter jurisdiction. The court retained jurisdiction pending further findings by the district court.⁴³

In the more recently decided Second Circuit case, *IIT v. Cornfeld*,⁴⁴ the court, professing to rely on a conduct test, asserted subject matter jurisdiction over foreign defendants.⁴⁵ IIT, a foreign corporation, brought action against American and foreign defendants.⁴⁶

36 *Id.* at 988.

37 *Id.* at 987. See note 35 *supra*.

38 The court classified defendants' activities within the United States as "merely preparatory" and small in comparison to those abroad. *Id.* at 987.

39 519 F.2d at 1004-11. The president of defendant Vencap, however, was an American citizen residing abroad. *Id.* at 1004.

40 *Id.* at 1006.

41 *Id.* at 1018.

42 "[W]e see no reason," the court posited, "why [such activity] could not also be regarded substantively as the acts that consummated the fraud." *Id.*

43 *Id.* at 1019. The district court had asserted jurisdiction on unclear grounds. *Id.* at 1015-17.

44 619 F.2d 909 (2d Cir. 1980).

45 The district court had determined that the effects alone on American investors were not sufficient to confer subject matter jurisdiction. The Court of Appeals for the Second Circuit upheld this determination: "In this the judge was clearly right, and we need say no more about 'effects' as a basis of subject matter jurisdiction save in one respect. . . ." *Id.* at 917.

46 In *Cornfeld*, plaintiffs claimed that various American and foreign defendants, including American accountants and underwriters, violated anti-fraud provisions of the securities laws

IIT had purchased stock from an American defendant in one transaction and from a foreign subsidiary of an American corporation in a related transaction.⁴⁷ With respect to the former sale, the court found that the American nationality of the issuer⁴⁸ and the consummation of the transaction in the United States⁴⁹ justified asserting jurisdiction. With respect to the latter sale, the court determined that the stock was nominally issued by a foreign subsidiary, but in substance issued by its American parent corporation.⁵⁰ Although the court employed "conduct" terminology, it asserted jurisdiction only because it found sufficient American ties.⁵¹

B. *The Third, Eighth, and Ninth Circuits*

The district court in *Grunenthal* based its denial of jurisdiction on Second Circuit precedent. The district court recognized, however, that the Eighth Circuit has followed a more liberal approach to the assertion of jurisdiction in transnational securities fraud cases and noted that adherence to Eighth Circuit precedent would probably justify asserting jurisdiction over the *Grunenthal* controversy.⁵² Indeed, the Ninth Circuit did rely in part on an Eighth Circuit case, *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*,⁵³ in reversing the district court.

In *Continental Grain*, plaintiffs alleged that defendants devised a scheme of fraudulent nondisclosure in violation of United States se-

by misrepresenting the financial condition of the corporation from which plaintiff purchased stock. *Id.* at 914-16.

47 *Id.* at 914.

48 *Id.* at 918.

49 *Id.*

50 The securities were, in substance, American rather than foreign. *Id.* at 920.

51 "We see nothing foreign in this transaction," the court concluded, "except that the purchaser was a foreigner and the orders were transmitted from abroad." *Id.* at 918.

52 *Grunenthal GmbH v. Hotz*, 511 F. Supp. 582, 588.

53 The Ninth Circuit stated:

In reaching this conclusion, we recognize that the Eighth Circuit has adopted a more liberal approach to the assertion of jurisdiction in transnational securities fraud cases. In *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.* . . . a case involving "a substantially foreign transaction, little if any domestic impact, and domestic conduct which counted for the most part of the use of the mail and telephones" . . . the Eighth Circuit held that subject matter jurisdiction was appropriate where "some activity designed to further a fraudulent scheme occurs within the country." . . . Were we to follow *Continental Grain*, it would probably justify the existence of subject matter jurisdiction in this case. We believe, however, that the line of cases from the Second Circuit is more in keeping with the expressions of the Ninth Circuit.

Id.

curities law.⁵⁴ Defendants had used instrumentalities of interstate commerce and had executed a contract with plaintiffs in California.⁵⁵ While the court determined that the allegedly fraudulent transaction did not affect American investors, it nonetheless ruled that jurisdiction could exist solely because material, fraudulent conduct occurred in the United States.⁵⁶ The Eighth Circuit set forth the conduct test as follows:

[T]he absence of a domestic plaintiff, domestic securities, or the use of a national securities exchange, in short the absence of domestic impact or effect, will not necessarily preclude a finding of subject matter jurisdiction. Instead, we examine the relationship between the defendants' conduct within the United States and the alleged fraudulent scheme, specifically whether defendants' conduct within the United States was significant with respect to the alleged violation . . . and whether it furthered the fraudulent scheme. . . . The conduct within the United States cannot be "merely preparatory" . . . and must be material, that is, "directly cause the losses". . . . In our opinion, finding subject matter jurisdiction after such an analysis is consistent with the subjective principle of international law, the intent of Congress and the remedial purpose of the federal securities laws.⁵⁷

The court found the parties' domestic conduct material to the alleged fraud and refused to dismiss for lack of jurisdiction.⁵⁸

The Third Circuit, in *SEC v. Kasser*,⁵⁹ also upheld the assertion of subject matter jurisdiction over a foreign securities fraud case because material, fraudulent conduct occurred within the United States.⁶⁰ The fraudulent transaction alleged in this case did not af-

54 592 F.2d 409 (8th Cir. 1979). The plaintiffs brought suit for violations of federal securities laws, common law fraud, and breach of contract. Several of the defendants were American, as was Continental Grain Corp., the parent company of Continental Grain Pty. Ltd. Both the district court and the court of appeals judged this an insufficient effect for the "effects test." The court of appeals, however, was willing to assert jurisdiction on a "conduct test" basis. *Id.* at 417.

55 *Id.* at 412-13. The plaintiffs alleged that Pacific Oilseeds obtained Continental Grain through a scheme of fraudulent nondisclosure. Besides the closing meeting in California, the domestic conduct involved transportation to and from the United States and the use of telephones and the mails.

56 *Id.* at 420.

57 *Id.*

58 The Eighth Circuit concluded: "In our view, defendants' conduct was significant and not 'merely preparatory.' Even though the ultimate effect, that is, Continental's purchase of PacSeeds, was felt in Australia, the fraudulent scheme of nondisclosure was devised and completed in the United States. Then it was 'exported' to Australia." *Id.* at 420.

59 548 F.2d 109 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977).

60 *Id.* at 114.

fect American investors or the domestic securities market.⁶¹ Material aspects of the alleged fraud, however, occurred within the United States, including use of the United States mail system,⁶² operation in part from corporate offices in America,⁶³ and execution of contracts in the United States.⁶⁴ In asserting jurisdiction, the Third Circuit reasoned that Congress did not intend to allow the United States to become a "Barbary Coast" . . . harboring international securities 'pirates.'"⁶⁵

The Ninth Circuit relied in *Grunenthal* on the *Continental Grain* and *Kasser* opinions as authority for reversing the district court decision and adopting the conduct test. *Grunenthal* involved a securities fraud action by a foreign plaintiff against foreign defendants.⁶⁶ The plaintiff alleged that the defendants made misrepresentations con-

61 The SEC brought the complaint for injunctive relief based on an alleged scheme to defraud a Canadian corporation. The district court dismissed on the grounds that, while there was domestic conduct, there was not the required domestic effect. *Id.* at 112. The Eighth Circuit reversed, finding the domestic conduct sufficiently material to justify American jurisdiction, even though there was no particular effect upon American investors. *Id.* at 112, 115.

62 *Id.* at 111.

63 *Id.*

64 *Id.*

65 *Id.* at 116. The court stated:

From a policy perspective . . . we believe that there are sound rationales for asserting jurisdiction. First, to deny such jurisdiction may embolden those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations. By sustaining the decision of the district court as to the lack of jurisdiction, we would, in effect, create a haven for such defrauders and manipulators. We are reluctant to conclude that Congress intended to allow the United States to become a "Barbary Coast," as it were, harboring international securities "pirates."

Following the same line of reasoning, the court asserted:

As a final policy justification for asserting jurisdiction here, we register the opinion that the anti-fraud provisions of the 1933 and 1934 acts were designed to insure high standards of conduct in securities transactions within this country in addition to protecting domestic markets and investors from the effects of fraud. By reviving the complaint in this case, the court will enhance the ability of the SEC to police vigorously the conduct of securities dealings within the United States.

Id. This reasoning was adopted by the Ninth Circuit in *Grunenthal*. See notes 84-92 *infra* and accompanying text.

66 712 F.2d 421, 422 (9th Cir. 1983). The case has international representation:

All the defendants and the plaintiff in this case are either foreign citizens or foreign corporations. Plaintiff *Grunenthal* is a West German corporation. Defendant *Productos* is a Mexican corporation controlled through a chain of Bahamian holding companies by a trust based in the Bahamas. The beneficiary of the trust, defendant Paul Hotz, is a citizen of Switzerland and a resident—during at least some of the year—of Italy. Defendant Joseph Lowe, the managing director of *Productos*, is a citizen and resident of Mexico.

cerning an agreement to sell all defendants' common stock.⁶⁷ The transaction had no demonstrable effect on American investors.⁶⁸ However, the parties' final meeting occurred at the office of Grunenthal's American counsel in Los Angeles, where the defendants repeated their earlier misrepresentations and executed a contract.⁶⁹ In connection with this meeting, the defendants used instrumentalities of interstate commerce.⁷⁰ The court characterized defendants' conduct as material to the alleged fraud⁷¹ and found that it was "consistent with the established objectives of the federal securities laws" to adopt the conduct test as developed by the Third and Eighth Circuits.⁷² Only by adopting the conduct test, the court reasoned, could the United States securities laws have their full effect upon the ethical standards of the American business community.⁷³ Thus, the plaintiffs were permitted to invoke the jurisdiction of United States courts.

C. *Consistency Among the Circuit Courts*

The Ninth Circuit in *Grunenthal* had ample precedent from the Third and Eighth Circuits to justify jurisdiction based on the con-

67 The plaintiff made two allegations: first, Hotz falsely represented both that he was the beneficial owner of Productos and that he would cause all its shares to be transferred to Grunenthal pursuant to the Los Angeles contract; second, at the meeting in Los Angeles, Hotz and Lowe misrepresented their present intention to perform the agreement. *Id.* at 423.

68 The Ninth Circuit did not question this factual holding of the district court. *Id.* at 423-24.

69 The final meeting took place in Los Angeles, California, at the law office of Grunenthal's American counsel. The purpose of the meeting was to execute the sales contract. All the principals were present: Lowe, Bernau, other representatives of Grunenthal, and the United States counsel for both Hotz and Grunenthal. At this meeting Lowe stated that Hotz controlled Productos. Hotz neither qualified nor denied Lowe's statement. Hotz and the representatives of Grunenthal then signed the agreement. *Id.* at 423.

70 The court stated that there was "no dispute that defendants used instrumentalities of interstate commerce to effect the alleged fraud by, at a minimum, using such instrumentalities to attend the Los Angeles meeting." *Id.* at 425 n.6.

71 The court concluded:

Although Grunenthal had previously been told by Lowe that Hotz controlled Productos, the Los Angeles meeting furthered the fraudulent scheme because Hotz for the first time, through his silence, confirmed the claim that he owned Productos. Hotz's conduct in this country was not "merely preparatory"; rather, the conduct was "material" because immediately thereafter defendants signed and plaintiff was induced to execute the agreement. . . . Moreover, the execution of the agreement in Los Angeles itself constituted an act that strongly supports our assertion of jurisdiction. The signing of the statement by Hotz can be regarded as a definitive statement by him that he was in a position to complete the transaction.

Id. at 425.

72 *Id.* at 424.

73 *Id.* at 424-25. See notes 84-92 *infra* and accompanying text.

duct test.⁷⁴ In employing the conduct test, however, the Ninth Circuit declared that "assertion of jurisdiction on the facts of this case is not inconsistent with the approach taken by the Second Circuit."⁷⁵ Indeed, the court cited as support for the conduct test the same Second Circuit cases which the district court used to dismiss for lack of jurisdiction.⁷⁶

The Ninth Circuit's position is supported in two ways. First, the Second Circuit already recognizes the conduct test, at least in theory, as a legitimate means of asserting jurisdiction over foreign securities fraud cases.⁷⁷ In *Bersch*, for example, the Second Circuit might have asserted jurisdiction on the basis of the conduct test, had the defendants' conduct been more than "merely preparatory."⁷⁸ In *Vencap*, the Second Circuit affirmed that fraudulent acts themselves, if not merely preparatory, may justify the assertion of jurisdiction.⁷⁹ Moreover, the Second Circuit has favorably cited *Continental Grain*,⁸⁰ which involves perhaps the most controversial use of the conduct test.⁸¹ In short, while the Second Circuit may employ a higher threshold for

74 See text accompanying notes 52-65 *supra*.

75 *Grunenthal GmbH v. Hotz*, 712 F.2d at 426.

76 *Id.* The cases cited include *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 1001 (2d Cir. 1975); *IIT v. Vencap*, 519 F.2d 1001 (2d Cir. 1975); and *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980).

77 Even before *Bersch*, the Second Circuit, in *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972), stated in dictum: "Conduct within the territory alone would seem sufficient from the standpoint of *jurisdiction* to prescribe a rule." *Id.* at 1334 (emphasis in original). In *Leasco*, a United States corporation alleged that it was fraudulently induced to purchase British corporate stock. The court asserted jurisdiction on the basis of both conduct and effects. *Id.* at 1337.

78 *Bersch v. Drexel Firestone, Inc.*, 519 F.2d at 987. The court held that the securities laws apply where losses to a foreign plaintiff are "directly caused" by acts within the United States. *Id.* at 993. See note 35 *supra*.

79 *IIT v. Vencap*, 519 F.2d at 1081. The court provided:

Our ruling on this basis of jurisdiction is limited to the perpetration of fraudulent acts themselves and does not extend to preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries, such as in *Bersch*. Admittedly the distinction is a fine one. But the position we are taking here extends the application of the securities laws to transnational transactions beyond prior decisions and the line has to be drawn somewhere if the securities laws are not to apply in every instance where something has happened in the United States, however large the gap between the something and a fraud and however negligible the effect in the United States or on its citizens.

Id.

80 See *IIT v. Cornfeld*, 619 F.2d at 918.

81 Compare *Bersch* with *Continental Grain*. The conduct in the United States in these cases involved the similar use of instrumentalities of interstate commerce. Whereas in *Bersch*, the court classified defendants' conduct as preparatory with respect to the fraud, the court in *Continental Grain* determined that defendants' conduct constituted the organization and completion of the fraud. See notes 34-38 and 54-58 *supra* and accompanying text. While the two

materially fraudulent conduct, it nonetheless recognizes the conduct test.⁸² The Second Circuit will assert jurisdiction on the basis of conduct alone where it finds conduct sufficiently material to the fraud.⁸³

Second, the more liberal jurisdictions recognize the importance of domestic impact. In *Grunenthal*, the district court declined to follow "more liberal"⁸⁴ jurisdictions because they did not require some effect on American investors as a prerequisite to invoking jurisdiction.⁸⁵ The Ninth Circuit in *Grunenthal*, however, makes clear that the Third, Eighth, and Ninth Circuits require at least a general effect on the American securities market before asserting jurisdiction.⁸⁶ While the Second Circuit looks for some direct impact on particular American investors,⁸⁷ the other circuits have focused on the more general debilitating effects on the American business community. For example, the *Grunenthal* court stated that expansion of federal

courts of appeals have conceptualized factual situations differently, they have applied the same basic conduct test.

82 At least one author has argued that *Continental Grain* conflicts with *Bersch*. See Comment, *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.: An Unjustifiable Expansion of Subject Matter Jurisdiction in a Transnational Securities Fraud Case*, 2 NW. J. INT'L LAW & BUS. 264 (1980) (stating that *Continental Grain* required only "significant conduct with respect to the fraud," whereas *Bersch* required "direct causation." *Id.* at 270).

The Eighth Circuit, however, cited this "direct causation" language in *Bersch*, see text accompanying note 57 *supra*, and determined that this test was satisfied. In *Kasser*, the Third Circuit made the same determination. 548 F.2d at 115. The *Kasser* court also pointed out that defendant's conduct constituted a "slowly unfolding scheme to defraud the plaintiffs." *Id.* at 111. This characterization of the activity probably accurately reflects the nature of most fraudulent securities transactions. Therefore, what "directly causes" plaintiff's losses becomes a difficult question. It is not surprising to find, then, especially considering the relative paucity of cases addressing this question, that courts have come to differing conclusions in applying the conduct test to similar factual situations. See note 81 *supra*.

83 Under what specific circumstances the Second Circuit will assert jurisdiction on the basis of conduct alone is speculative.

84 *Grunenthal GmbH v. Hotz*, 511 F. Supp. at 588.

85 *Id.*

86 *Grunenthal GmbH v. Hotz*, 712 F.2d at 424-25. See also *SEC v. Kasser*, 548 F.2d at 116; *Continental Grain v. Pacific Oilseeds, Inc.*, 592 F.2d at 421-22. One might ask why any effect is necessary to assert jurisdiction based on the conduct test. Strictly speaking, the effects noted are not prerequisite to, but are means of justifying, the assertion of jurisdiction based on conduct. These generalized effects inevitably accompany fraudulent domestic conduct, but are by themselves insufficient to confer jurisdiction.

87 The Second Circuit does not expressly require specific effects, but a review of the cases reflects that it has asserted jurisdiction only where such effects have been present. See text accompanying notes 25-51 *supra*. See also *Fidenas AG v. Compagnie Internationale Pour L'Informatique CII Honeywell Bull S.A.*, 606 F.2d 5 (2d Cir. 1979) (jurisdiction denied in 10b-5 action brought by foreign plaintiffs against foreign defendants, where the transaction had no measurable effect on the American securities market, and the alleged conduct in the United States included knowledge by defendant's American parent corporation, the court characterizing that conduct as secondary and ancillary to the fraud. *Id.* at 8.).

jurisdiction discourages foreigners who would use the United States as their base of operations in perpetrating securities fraud.⁸⁸ Also, such an exercise of jurisdiction helps prevent a "spill over"⁸⁹ of poor business ethics into the American business community.⁹⁰ As the Ninth Circuit observed: "Assertion of jurisdiction may encourage Americans — such as lawyers, accountants and underwriters — involved in transnational securities sales to behave responsibly and thus may prevent the development of relaxed standards. . . ."⁹¹ United States courts must enforce strict standards of compliance to maintain the overall effectiveness of American securities laws.⁹²

The *Grunenthal* decision, then, is consistent with Second Circuit precedent in that the Second Circuit has recognized the legitimacy of the conduct test, and the *Grunenthal* court, as well as the other "more

88 712 F.2d at 424-25.

89 *Id.* at 425.

90 *Id.*

91 *Id.* See also *Kasser*, 548 F.2d at 116: "[T]he antifraud provisions of the 1933 and 1934 acts were designed to insure high standards of conduct within this country in addition to protecting domestic markets and investors from the effects of fraud." *Id.*

The *Kasser* court also expressed that other nations should, in reciprocal fashion, take action against United States defrauders who conduct business within their territory. This would prevent "defrauders beyond the reach of our courts to escape with impunity." *Id.* at 116.

92 Where a court determines that the effectiveness of United States securities laws are not in question, it is not necessarily locked into hearing the case if it asserts jurisdiction. The doctrine of *forum non conveniens* may be used to avoid any undesirable consequences of basing jurisdiction on conduct alone. Indeed, much of the criticism leveled against the conduct test goes more toward the question of *forum non conveniens* than to that of jurisdiction. See Comment, *supra* note 82, at 273-75 ("by expansively interpreting the conduct test, *Continental Grain* not only approved the use of precious judicial resources in a predominantly foreign dispute, but it also opened the door to more vexatious litigation. . . ." *Id.* at 275).

In *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501 (1947), the Supreme Court outlined the factors to be considered in applying *forum non conveniens*. Considerations from the standpoint of the litigants include "the relative ease of access to sources of proof; availability of compulsory process for attendance of unwilling, and the cost of obtaining attendance of willing, witnesses; . . . and all other practical problems that make a trial of a case easy, expeditious and inexpensive." *Id.* at 508. Public interest concerns include the problems created "when litigation is piled up in congested centers instead of being handled at its origin," and the burden of jury duty "imposed upon the people of a community which has no relation to the litigation." *Id.* at 508-09. Another important consideration is the availability of an alternative forum. In *Gulf Oil*, an action in a New York court was dismissed on *forum non conveniens* where the court found that Virginia provided a more convenient forum. *Gulf Oil* has been recently upheld in *Piper Aircraft Co. v. Reyno*, 454 U.S. 235 (1981).

In cases of transnational securities fraud, a United States court may similarly dismiss a case using the doctrine of *forum non conveniens*. In such a case, the alternative forum would be in a foreign country. Nothing prohibits a court from finding such an alternative satisfactory. While United States courts have the power to enforce American securities laws where material, fraudulent conduct occurs within its borders, they also have the discretionary right to dismiss a case on public policy grounds.

liberal" circuits, shares the Second Circuit's concern that there be some effect on the domestic market to support jurisdiction based on the conduct test.

III. Conclusion

Grunenthal is a sound decision and reflects a growing acceptance of the conduct test as a means for asserting jurisdiction in transnational securities fraud cases. By discouraging the use of the United States as a base for foreign securities fraud, the decision protects the ethical standards of the American business community and helps fulfill the general purposes of United States securities laws.

The Third, Eighth, and now the Ninth Circuits have explicitly asserted jurisdiction on the basis of domestic conduct. Moreover, as the *Grunenthal* court asserted, the conduct test is consistent with Second Circuit holdings.⁹³ The conduct test, therefore, has become a justifiable basis for asserting jurisdiction over foreign securities fraud cases in all federal courts.

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93 See notes 74-92 *supra* and accompanying text.